

RECOVERING GROWTH: Rebuilding Dynamic Post-Covid Economies Amid Fiscal Constraints

Semiannual report for
Latin America and the Caribbean
World Bank – October 2021





CHAPTER 1

**FROM DEVASTATION
TO AN ANEMIC
RECOVERY PATH**

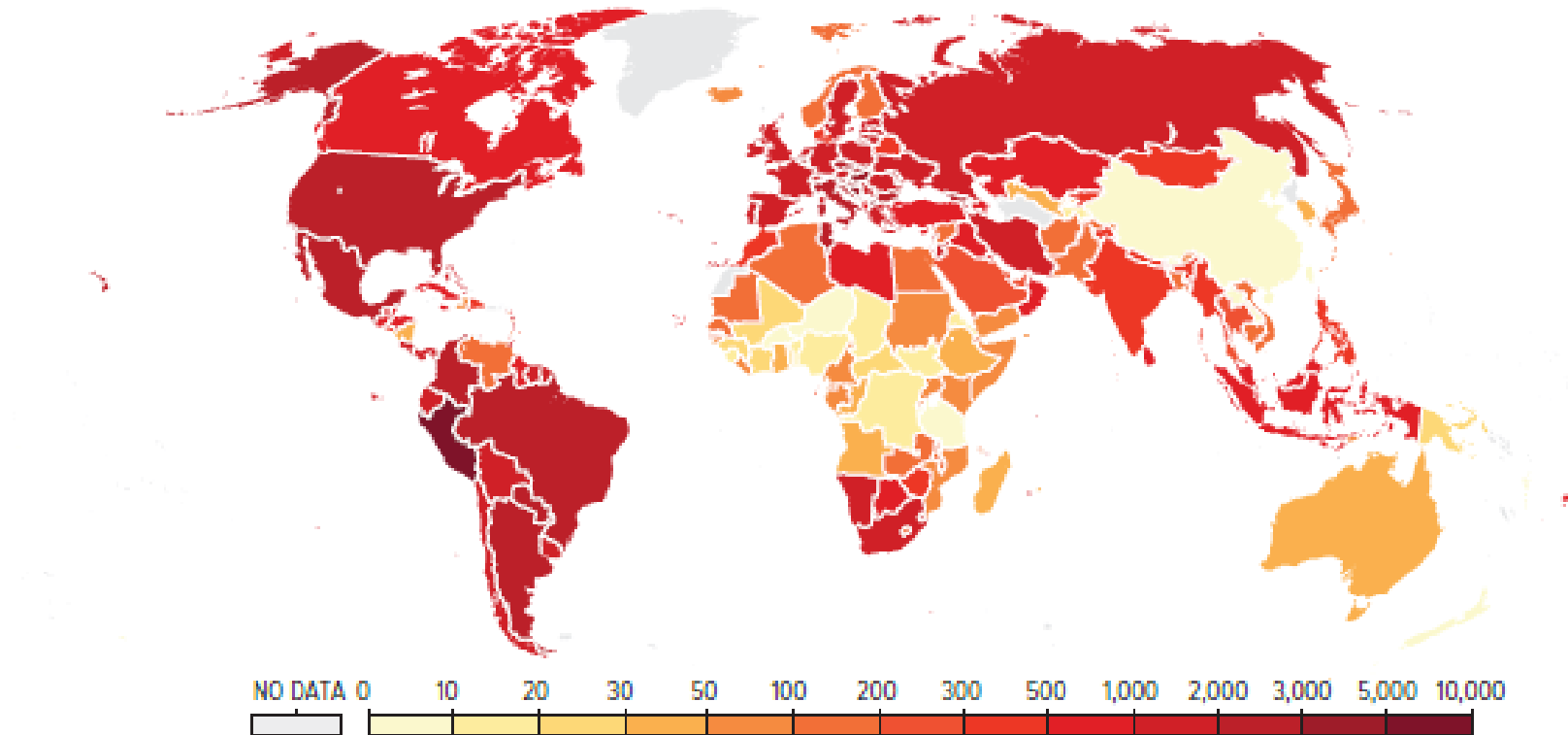
- The Ongoing Challenge of COVID-19
- The Devastating Human Costs
- Recovering, without Taking Off
- The Paradoxical Recovery
- Challenges to Recovery



The Ongoing Challenge of COVID-19

LAC is among the Most Affected Regions in the World

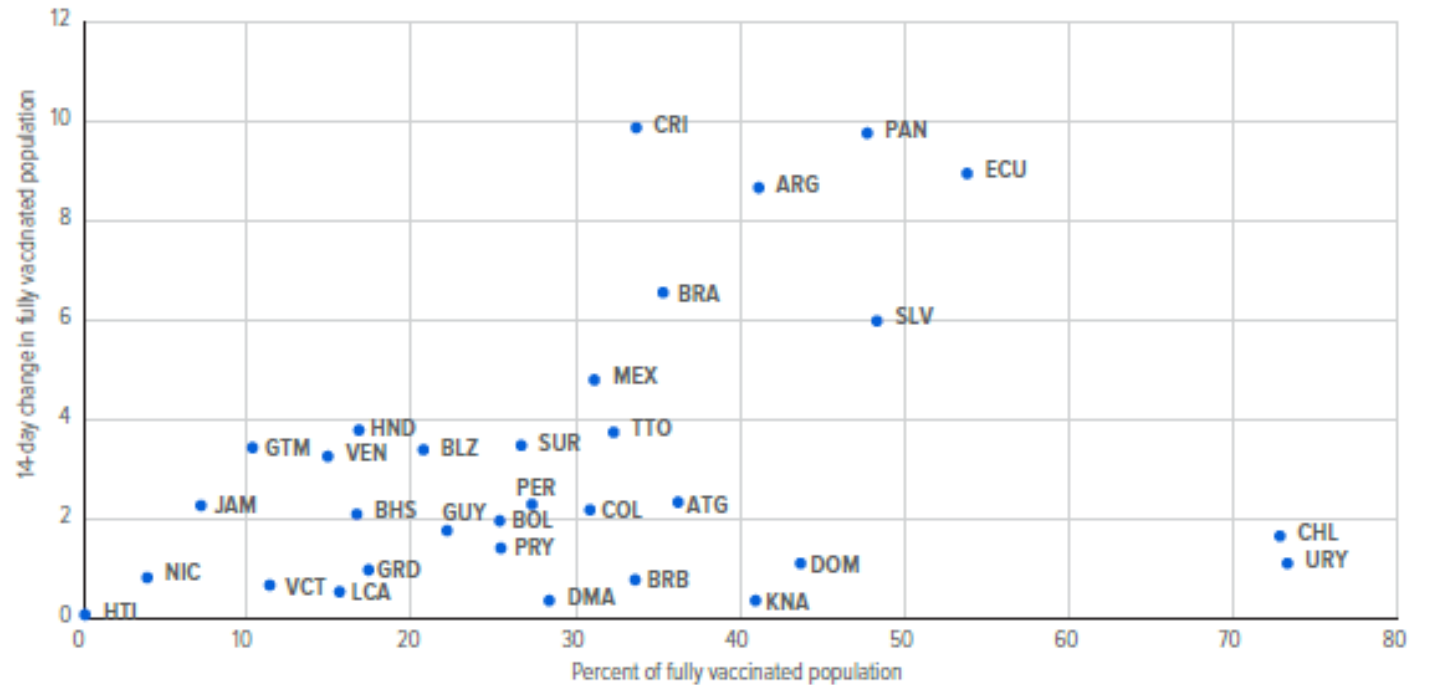
Figure 1.1: LAC Leads the World on Cumulative Confirmed Covid-19 Deaths



Note: Data reported as of September 20, 2021.

Much
Progress on
Vaccination,
But Still Much
To Do.

Figure 1.5: Progress in Vaccination Rates Varies Across the Region



Source: Our World In Data.

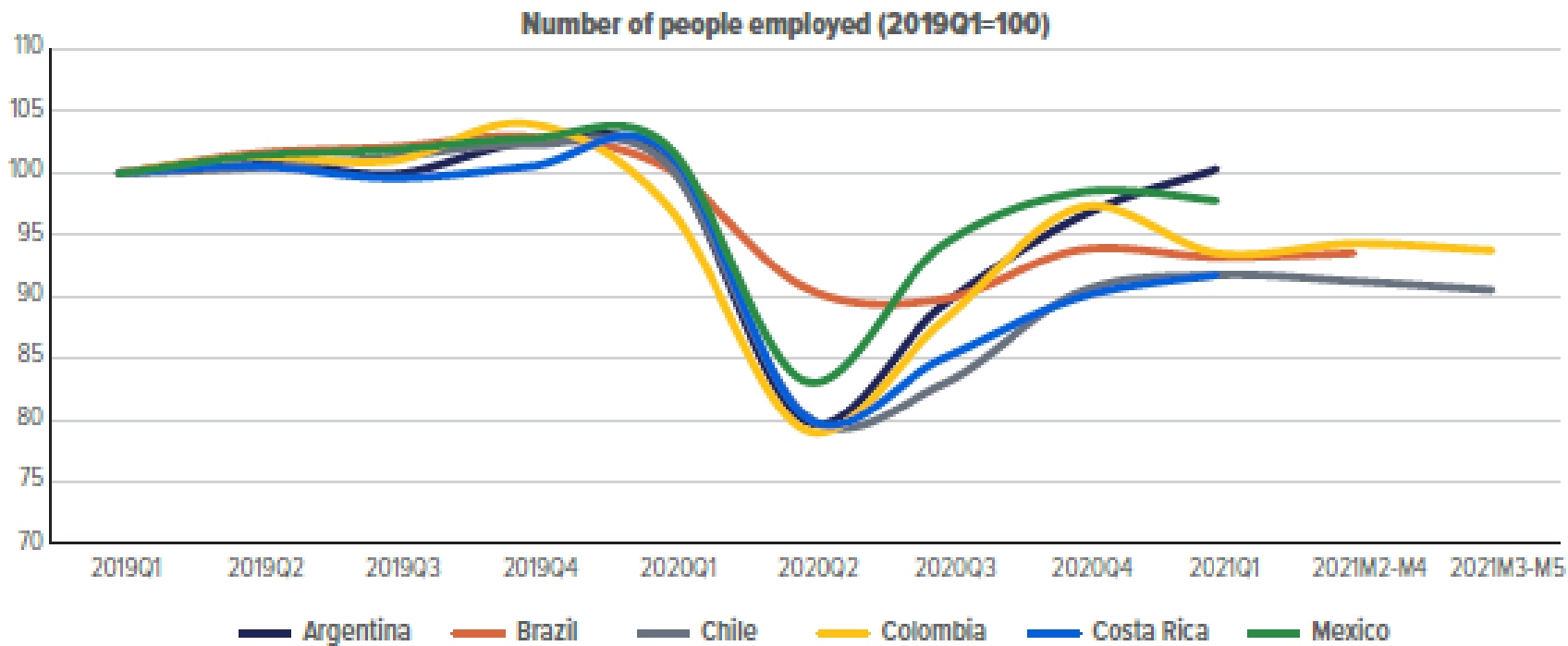
Note: The 14-day change is reported between August 28, 2021, and September 10, 2021.



The Devastating Human Costs

Employment Losses Were Vast and Have Not Been Fully Recovered

Figure 1.7: Employment Remains Below Pre-Pandemic Levels

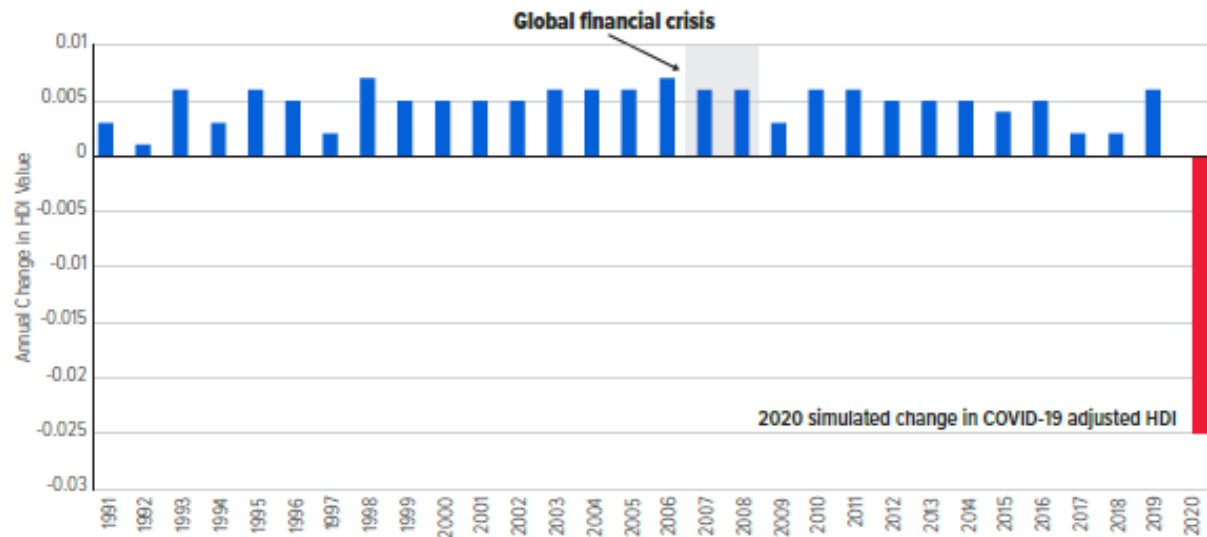


Possible permanent
2% increase in
informality

Sources: National statistical agencies and staff calculations.

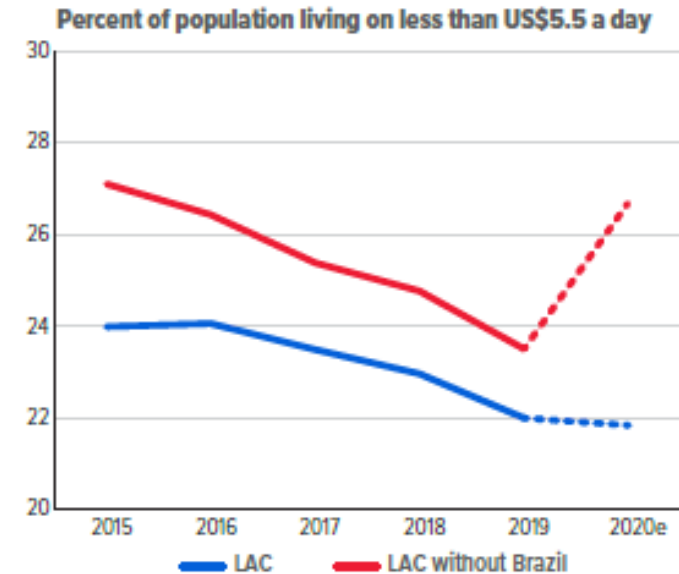
Human Welfare Has Worsened Across the Region

Figure 1.9: The Human Development Index Recorded Its Largest Drop



Sources: Human Development Index (HDI), Human Development Report (2020) and staff calculations.
Note: The HDI is reported for the World.

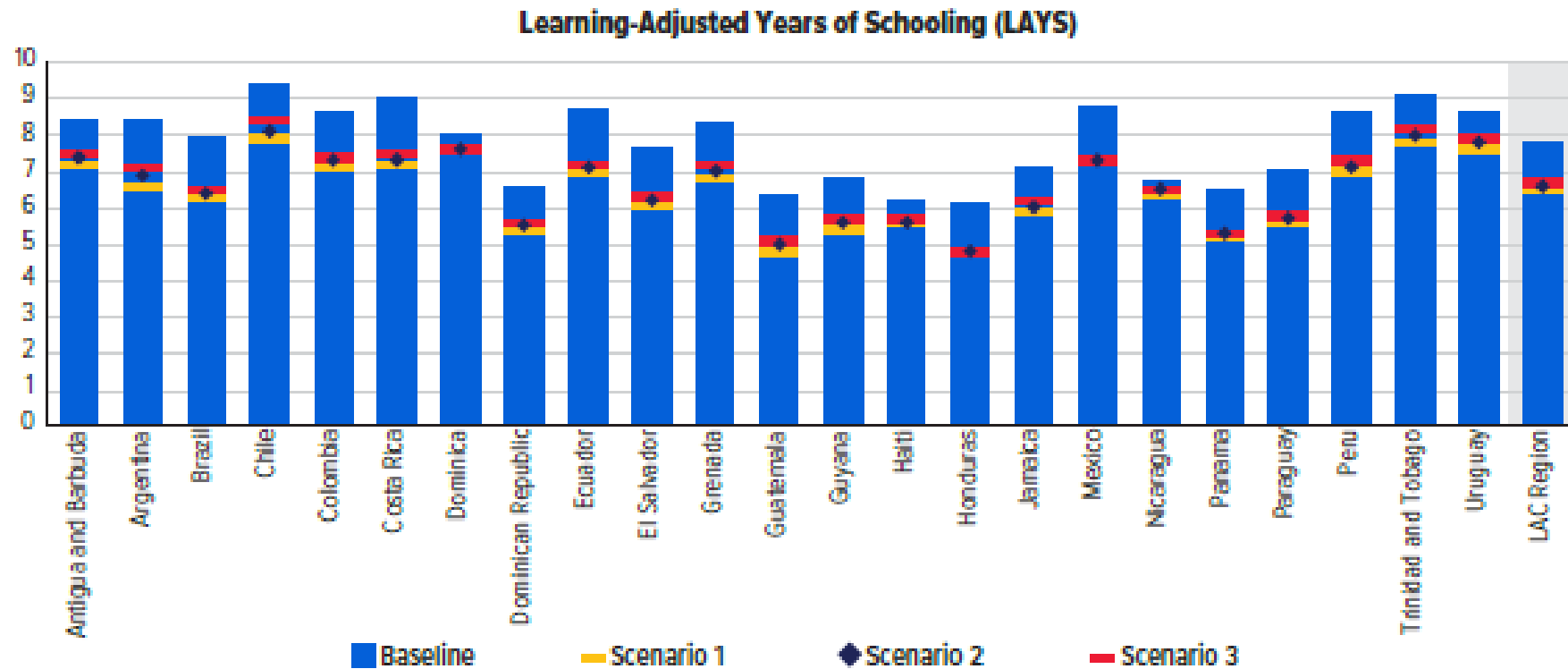
Figure 1.8: Without Brazil, Poverty Increased Sharply Throughout the Region



Source: World Bank (2021).
Note: e-estimate. The Latin America and Caribbean regional aggregate is estimated based on a sample of 18 countries (LAC-18).

The Loss of 1.5 Years of Schooling Will Impede Both Mobility and Productivity Growth

Figure 1.10: The Region Suffered Large Losses in Learning-Adjusted Years of Schooling

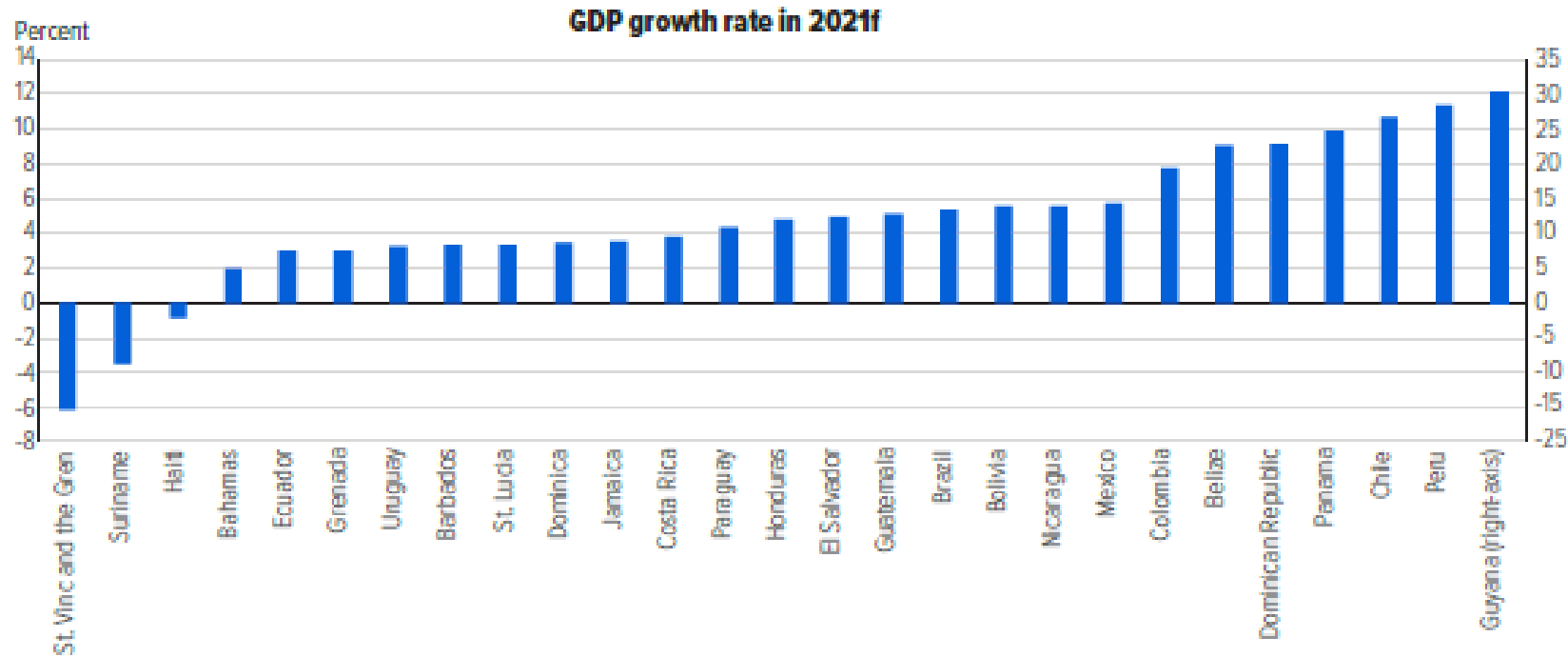


Source: World Bank Staff calculations.

Recovering Without Take Off

Growth Has Surpassed Previous Forecasts....and some new sectors emerging..

Figure 1.11: GDP Growth Rates Have Been Robust



Source: World Bank staff calculations.
Note: f - forecast


..But Not Enough to Recover 2020 Losses... and below what tailwinds would dictate.

Figure 1.12: Most Countries Have Not Regained their 2019 Levels of Income



2020: - 6.7%
2021f: 6.3%

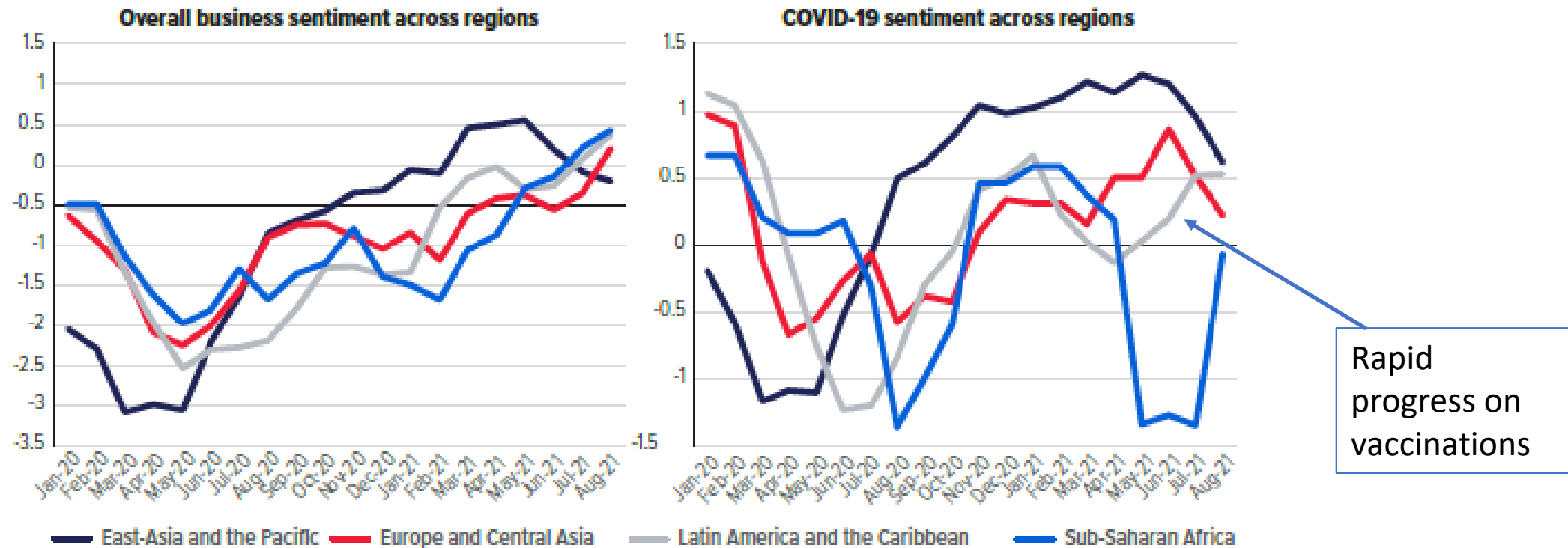
Source: World Bank staff calculations.
Note: e-estimate, f-forecast.



The Paradoxical Recovery:
A Return to Anemic
Growth Despite Favorable
Tailwinds

Business Expectations Are Recovering

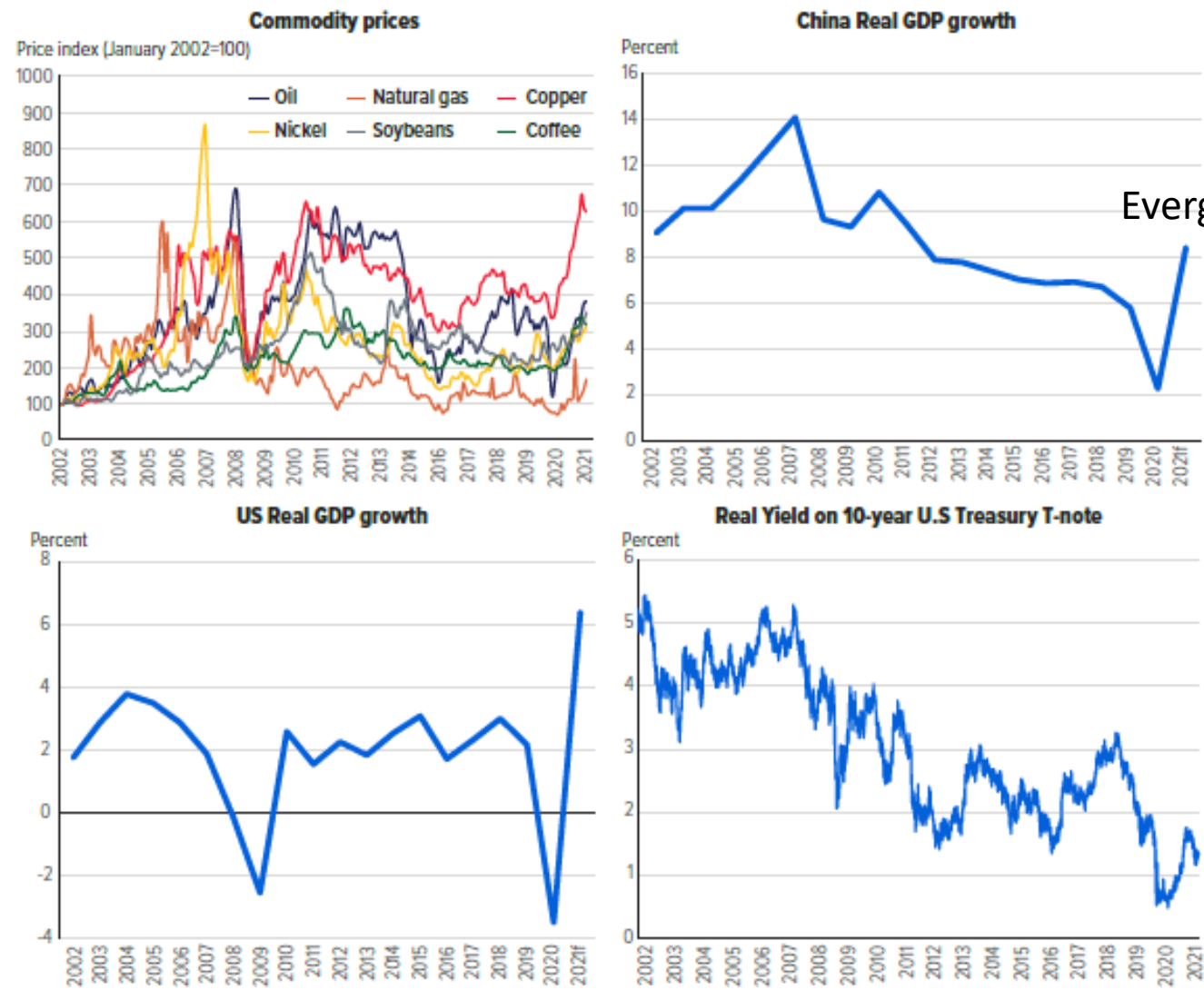
Figure 1.13: Machine Learning Estimates of Business Sentiment from Quarterly Earnings Calls Investors Are Shaking Off Concerns About Progress on COVID-19.



Source: Shl and Taskin (2021).

Global Factors Have Been Favorable

Figure 1.14: Tailwinds in Key External Factors

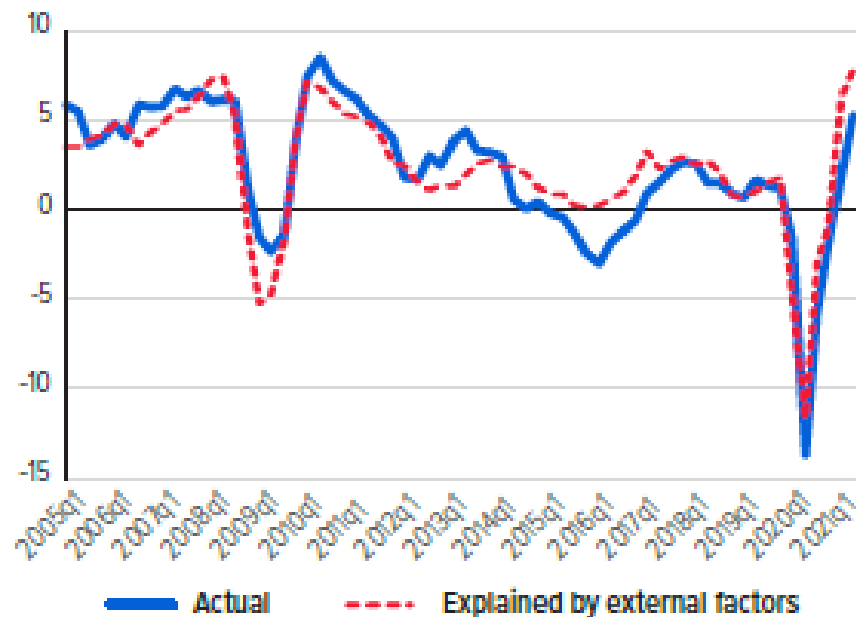


Sources: World Bank Commodity Prices (Pinksheets); IMF WEO; U.S. Department of Treasury.
Note: f-forecast

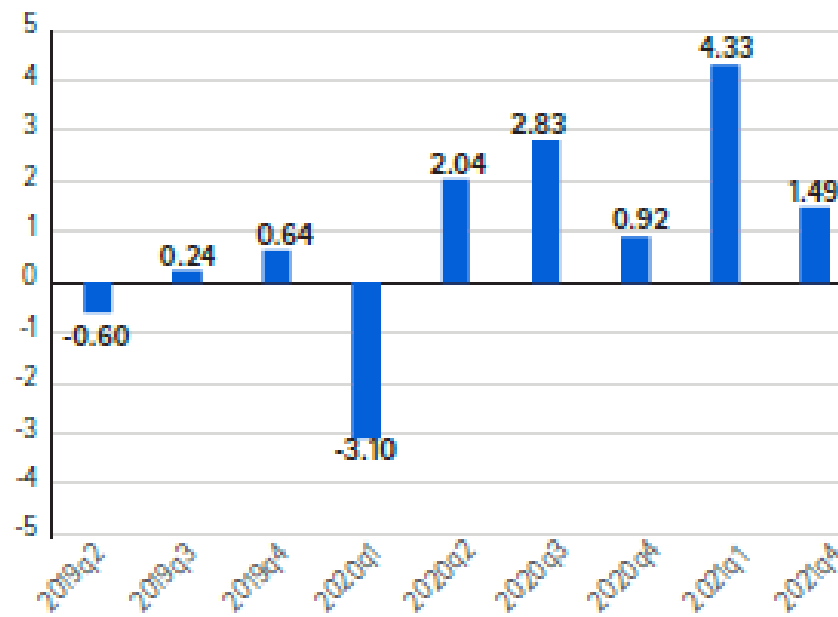
But the Region is Underperforming

Figures 1.15: Given Favorable Tailwinds, LAC Should Have Grown Faster in 2021

a: Observed vs. Predicted Growth by External Factors



b: Gap between Observed and Predicted Growth

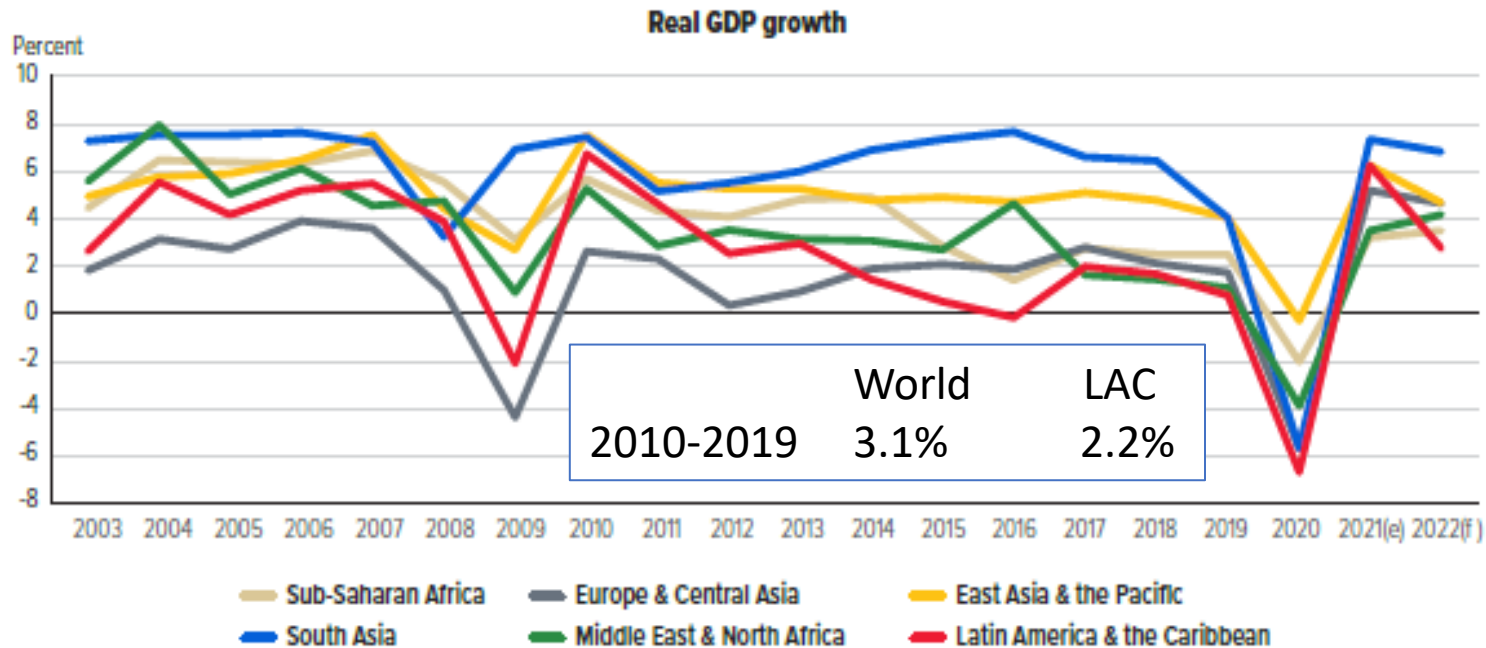


Source: World Bank staff calculations.

Note: Latin America Includes Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Peru, Paraguay, and Uruguay

...And Poised to Return to Low Growth Rates of the 2010s

Figure 1.6: From Low Growth to the Worst Recession



Forecasts are low...

2022: 2.8%

2023: 2.6%

...And similar to low rates of 2010s

Source: World Bank
Note: e-estimate; f-forecast

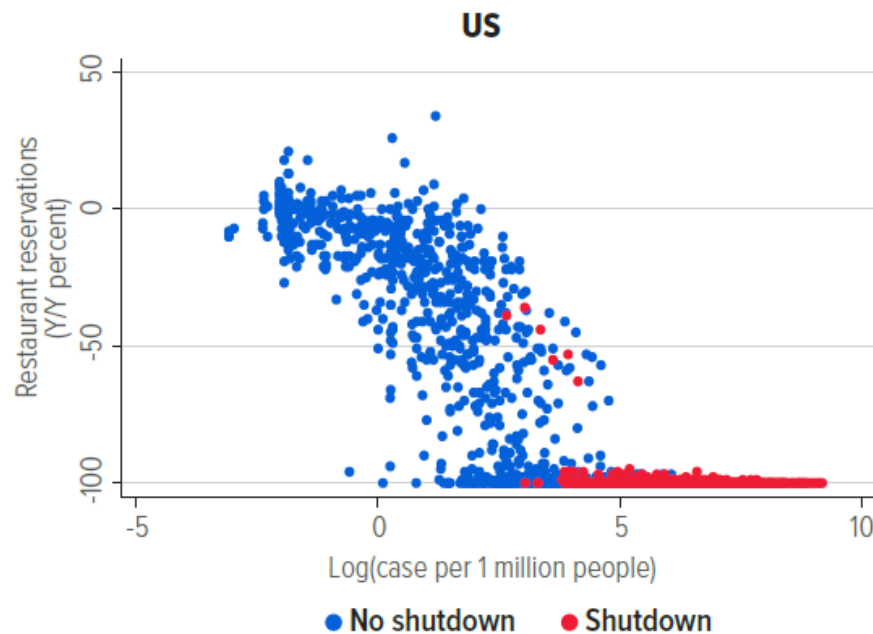


Challenges to the Recovery

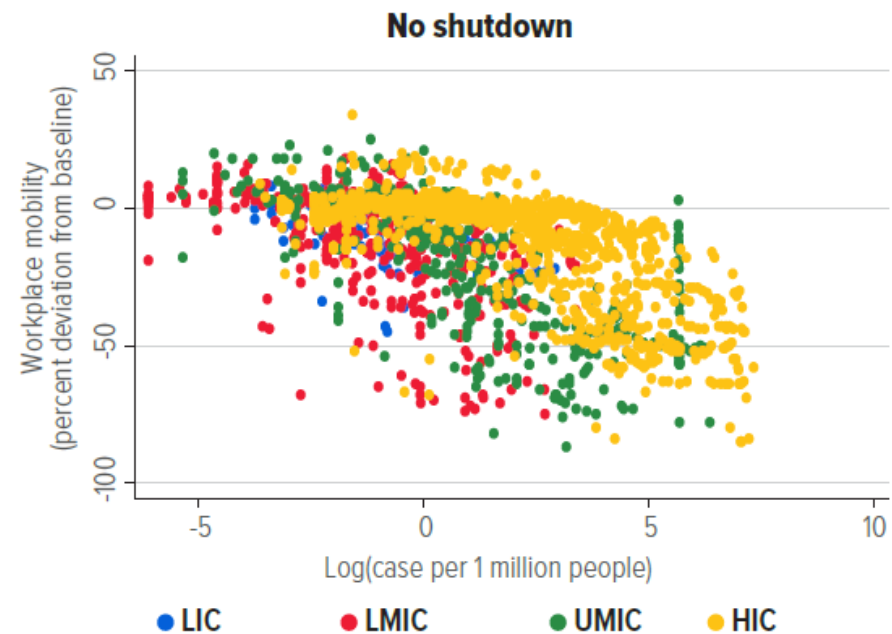
A New Variant Would Slow Recovery, Even Without Lockdowns

Figures 1.16: Much of the Slowdown in Activity Was Due to Voluntary Self Distancing

a. Decline in Restaurant Reservations vs. COVID-19 cases



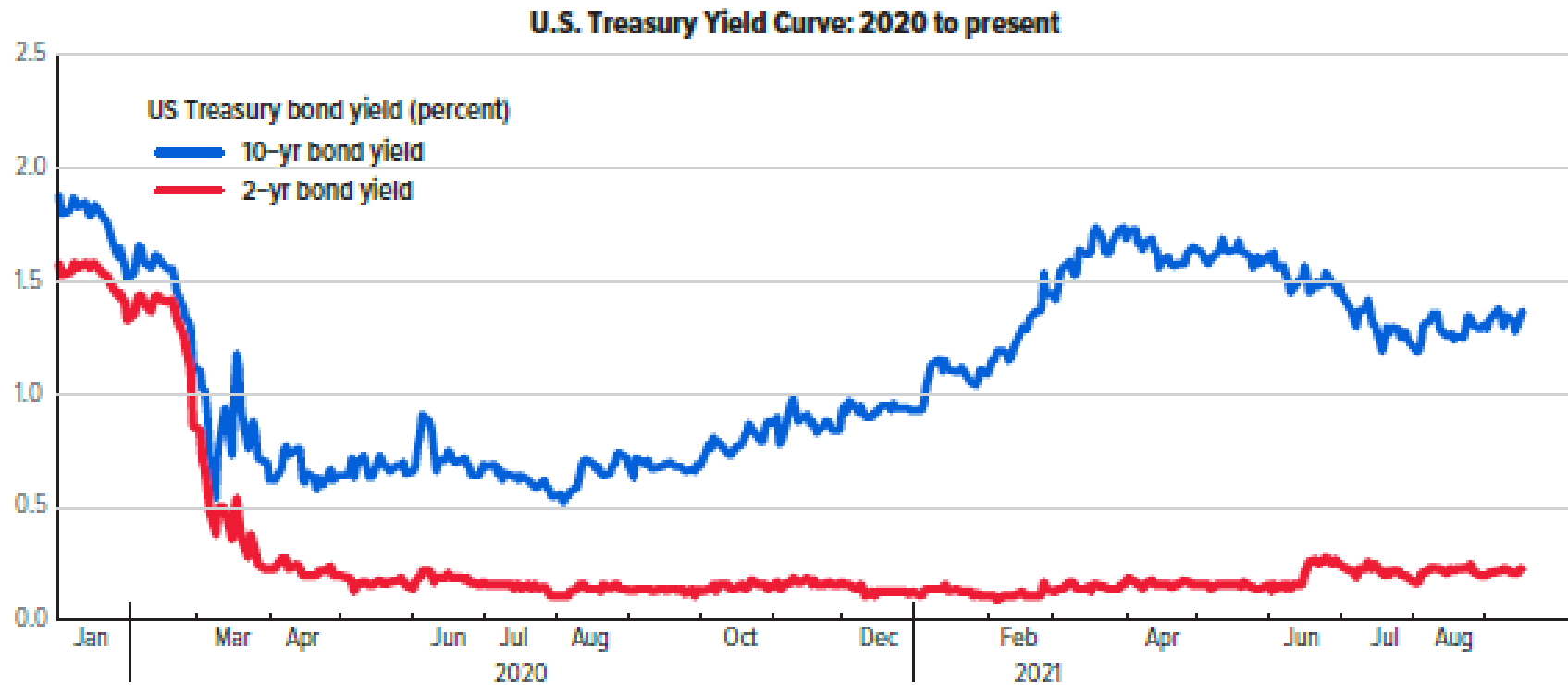
b. Workplace Mobility vs. COVID-19 Cases by Country Income Level



Source: Maloney and Taskin (2019).

Global Inflation Pressures Will Put Pressure on International Borrowing Costs

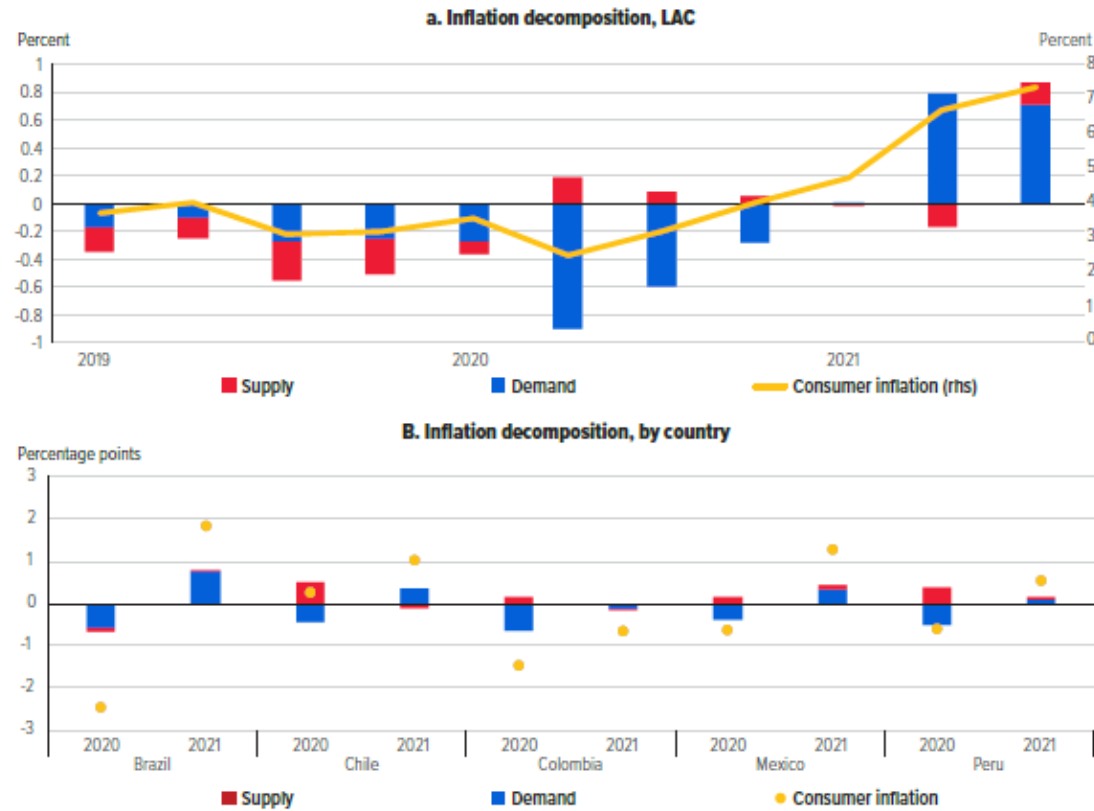
Figure 1.17: Steeper Yield Curve in the US May Indicate Higher Inflation in the Horizon



Source: US Department of Treasury.

Domestic Inflation is Largely Demand Driven Which May Require Higher Interest Rates

Figures 1.18: Inflation in LAC is Nudging Upward and is Largely Demand Driven

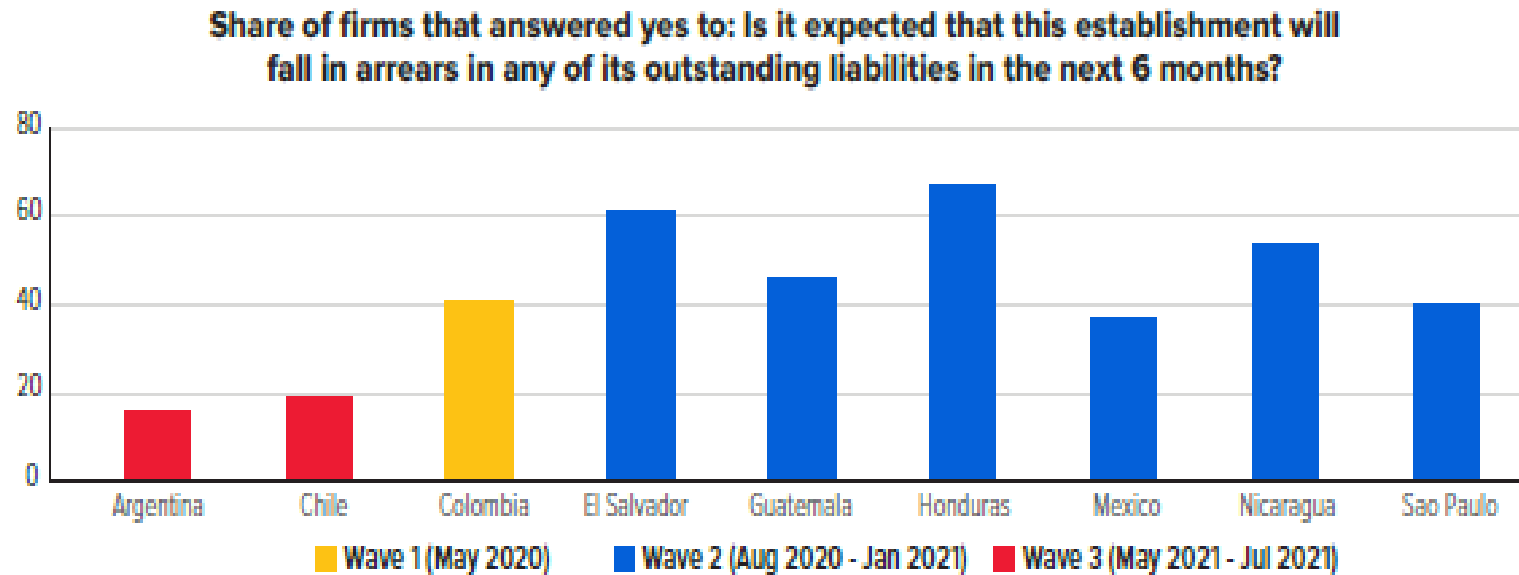


Source: Ruch and Taskin (forthcoming).

Note: Based on sign-restricted Bayesian VAR models. Decompositions only show demand and supply shocks and exclude other shocks. Shocks are measures as deviations from a model-based constant. Regional aggregates are a weighted average of Brazil, Chile, Colombia, Mexico, and Peru using 2020 constant GDP in USD. "Consumer Inflation" is shown as a deviation from a model-based constant or initial condition.

An Indebted Private Sector Will Show Sluggish Investment and May Undermine Financial Sectors.

Figure 1.19: Much of the Private Sector is in Arrears



Source: World Bank Pulse Surveys

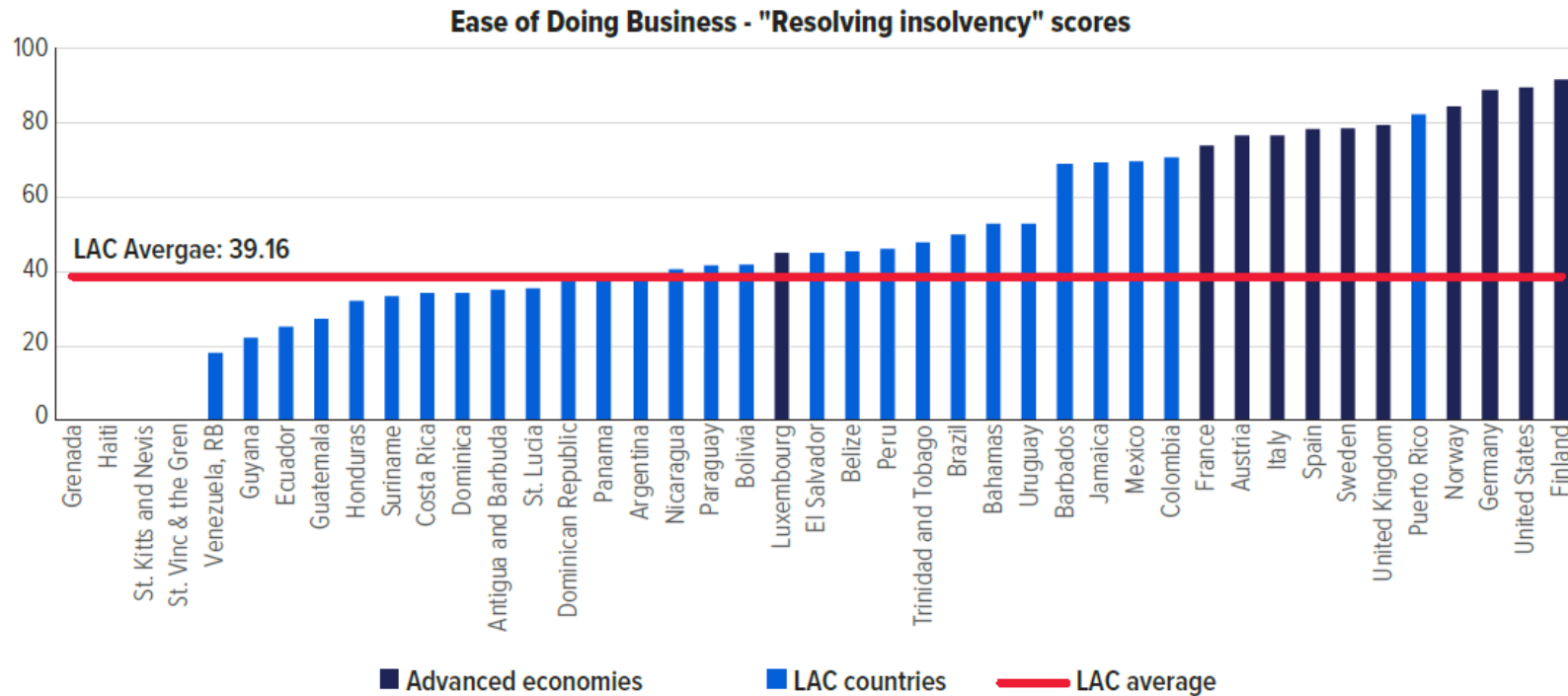
Note: Firms reporting the expectation of falling into arrears in any of their outstanding liabilities in the next 6 months. For Colombia, the questions refer to the expectation of falling into arrears within the next month. For Argentina, Chile and Sao Paulo, the figures include firms which are already in arrears at the time of survey.

Detransparentization of banking sector-can't see NPLs

WB Stress Tests: The median LAC country can handle 10PP more in NPLs before bottom 20% exhaust buffers

And We Need to Facilitate Debt Restructuring and Terminate Zombie Firms

Figure 1.20: LAC's Debt Resolution Mechanisms Need to Be Streamlined



Source: Doing Business 2020

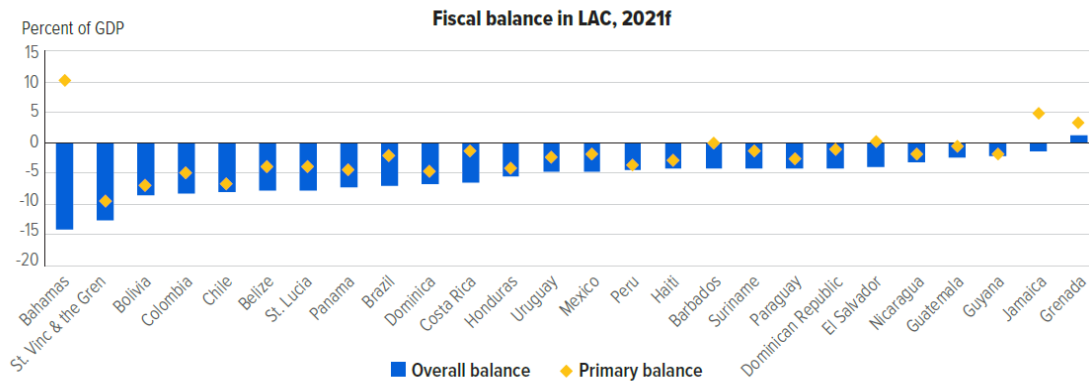
Note: The score for resolving insolvency is the simple average of the scores for each of the component indicators: the recovery rate of insolvency proceedings involving domestic entities, as well as the strength of the legal framework applicable to judicial liquidation and reorganization proceedings.

Disappearing Fiscal Space

The Extraordinary Efforts During the Crisis Have Led to High Deficits, Rising Debt, Rising Sovereign Spreads

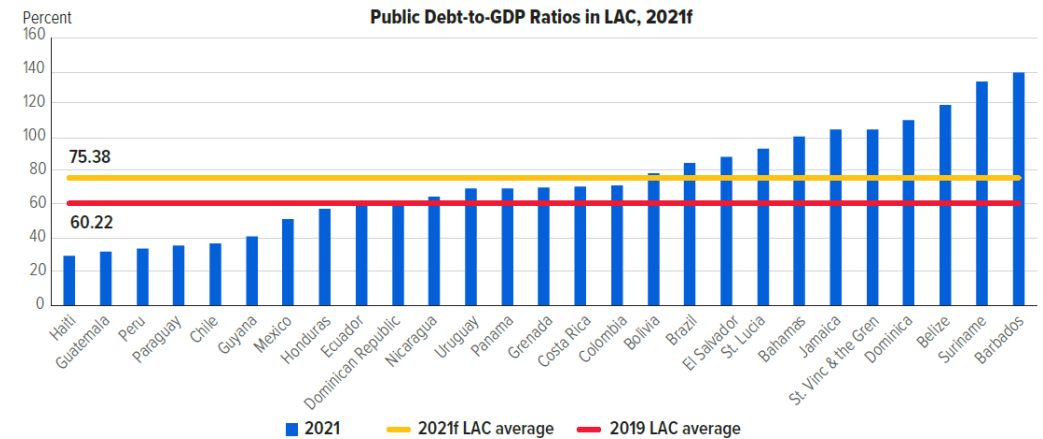
Rise in 15pp since 2019!

Figure 1.21: Widespread Overall and Primary Fiscal Deficits



Source: World Bank and staff calculations.
Note: f=forecast.

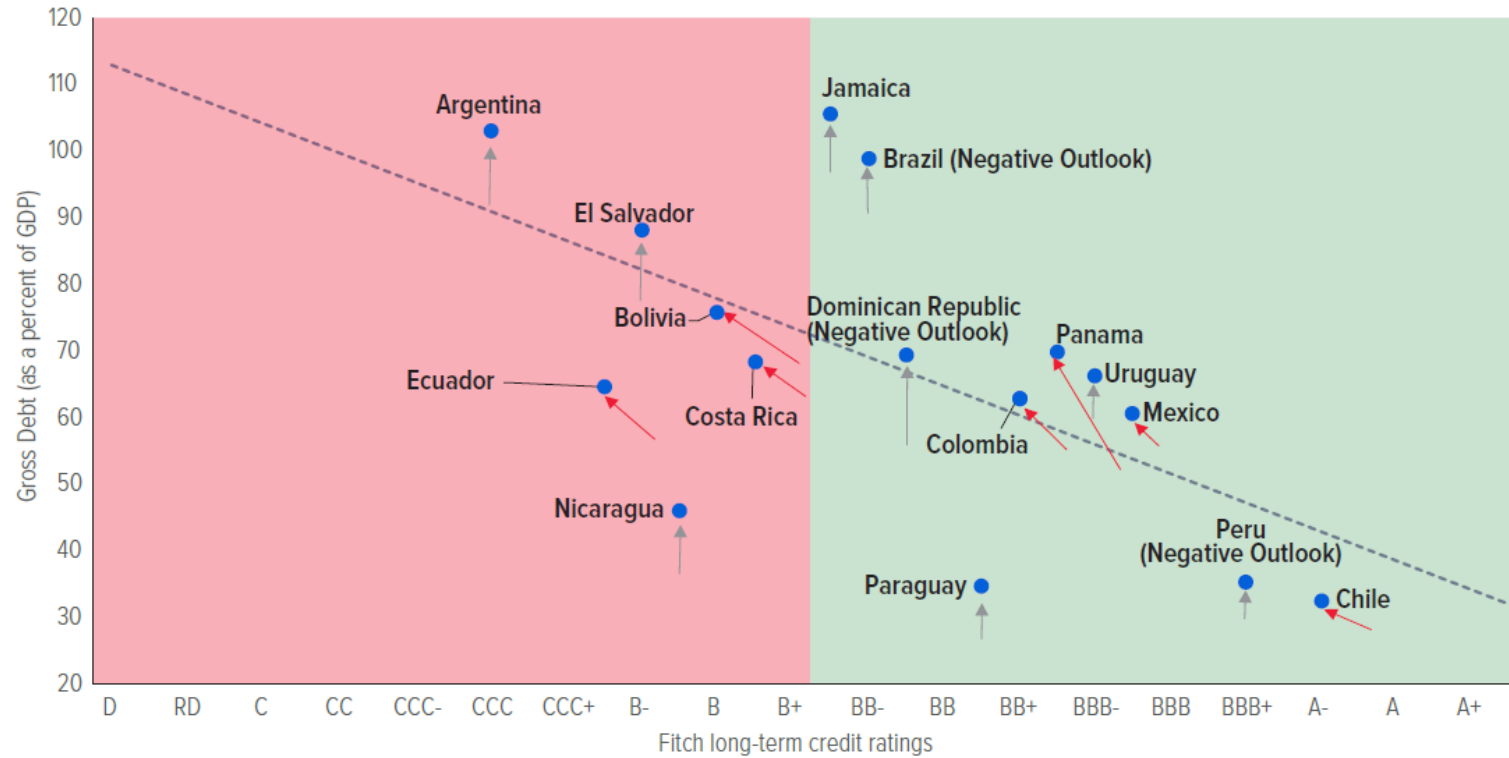
Figure 1.23: Public Debt is on the Rise



Source: World Bank and staff calculations.
Note: f=forecast.

And Weaker Sovereign Ratings... All of Which Reduce Fiscal Space and Limit Gov't Action.

Figure 1.24: As Debt Grows Sovereign Credit Ratings Slide



Sources: Fitch Ratings, World Bank and staff calculations.

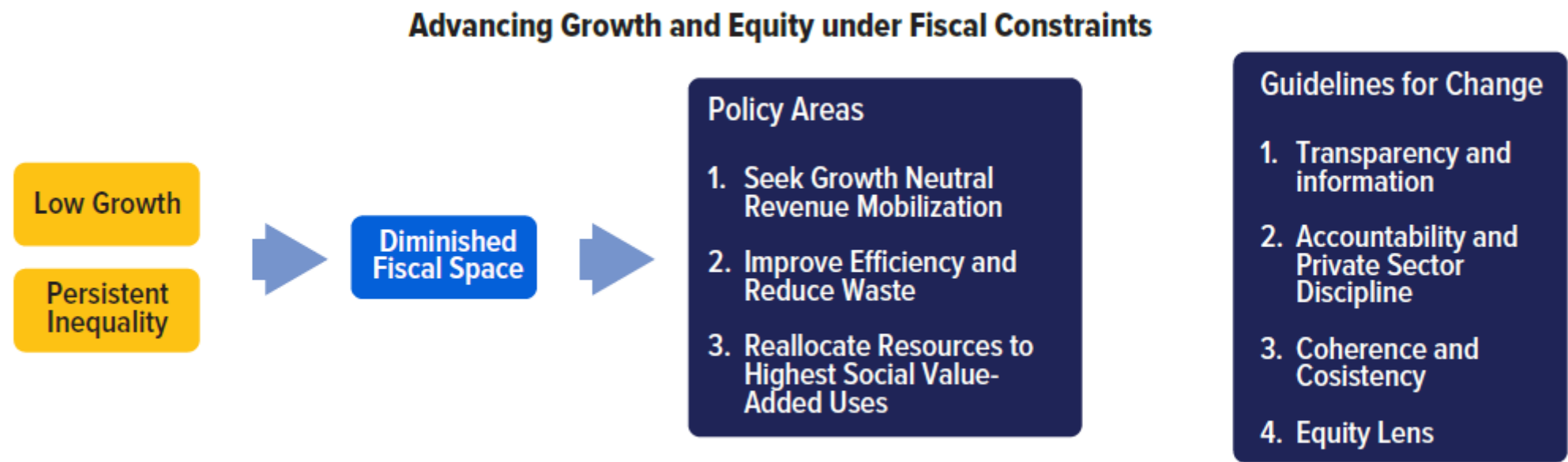


CHAPTER 2

REBUILDING A DYNAMIC INCLUSIVE AND GREENER ECONOMY IN A CONSTRAINED FISCAL ENVIRONMENT

- The Fiscal Challenge to Growth and Inequality
- Growth Neutral Revenue Mobilization
- Gains in Spending Efficiency
- Rethinking Spending Priorities

Figure 2.1: Advancing Growth, Equity and Sustainability under Fiscal Constraints

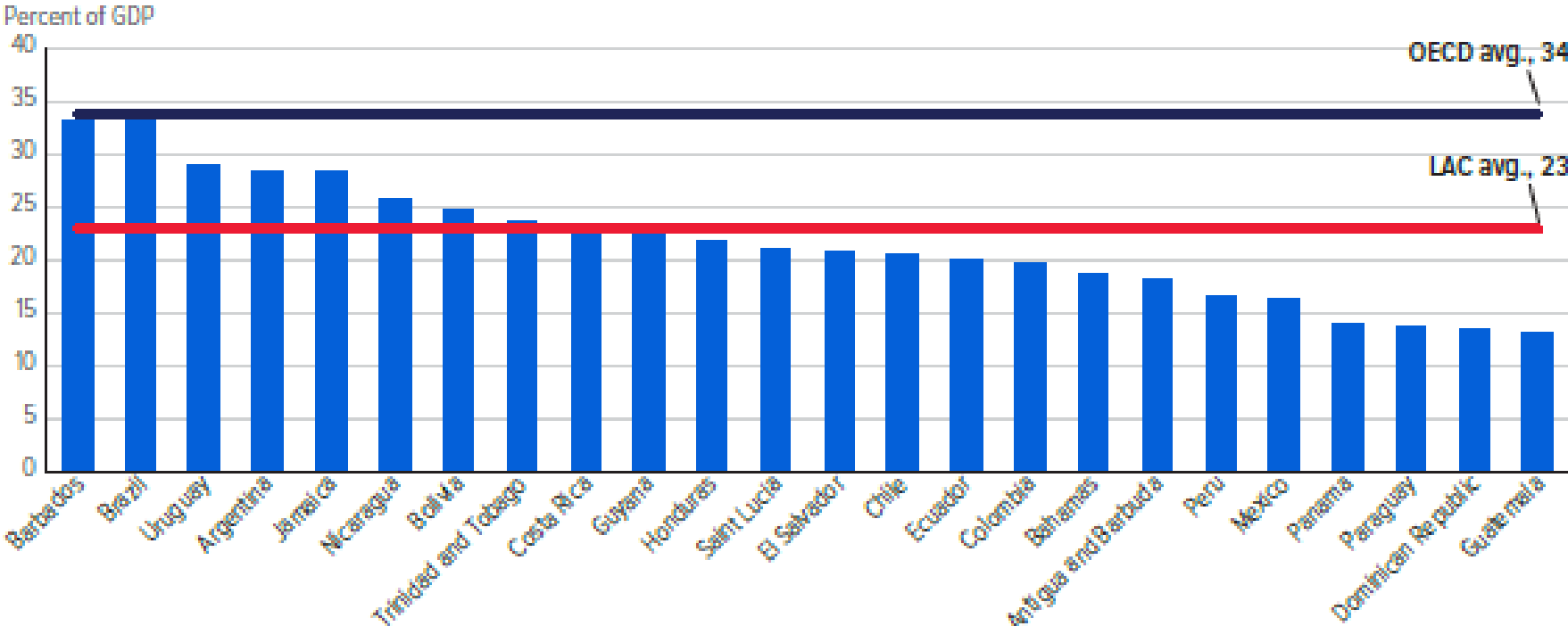




Growth Neutral Revenue Mobilization

There is Room for Growth-Neutral Revenue Mobilization

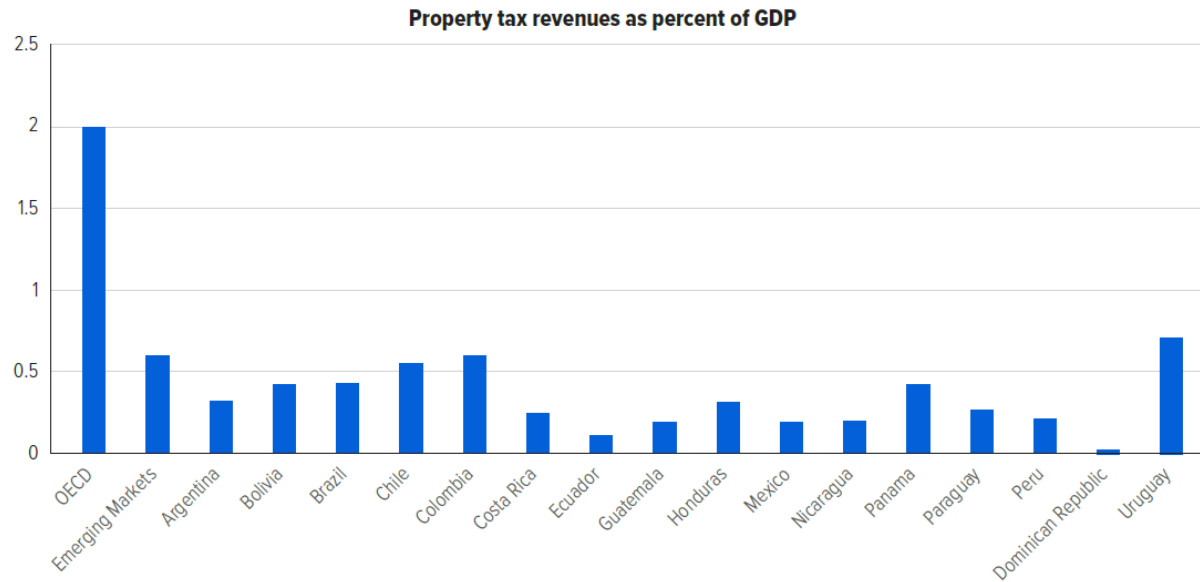
Figure 2.2: LAC Taxes are Substantially Less than the OECD



Source: OECD Global Revenue Statistics Database.
Note: Values are total tax revenues (as percent of GDP) for 2019.

But Different Sources Have Different Impacts on Growth

Figure 2.5: Latin America Taxes Property Less than Comparable Countries



Sources: Birdsall and Gupta (2018), Lincoln Institute of Land Policy.

- LAC Tax revenues are 23% vs 34% of GDP
- VAT-impact depends on current level.. At high levels increases have negative impact on GDP.
- Income taxes- more negative impact in LAC than in advanced countries.
- Property taxes- low and probably less problematic
- Carbon taxes, Sin taxes.

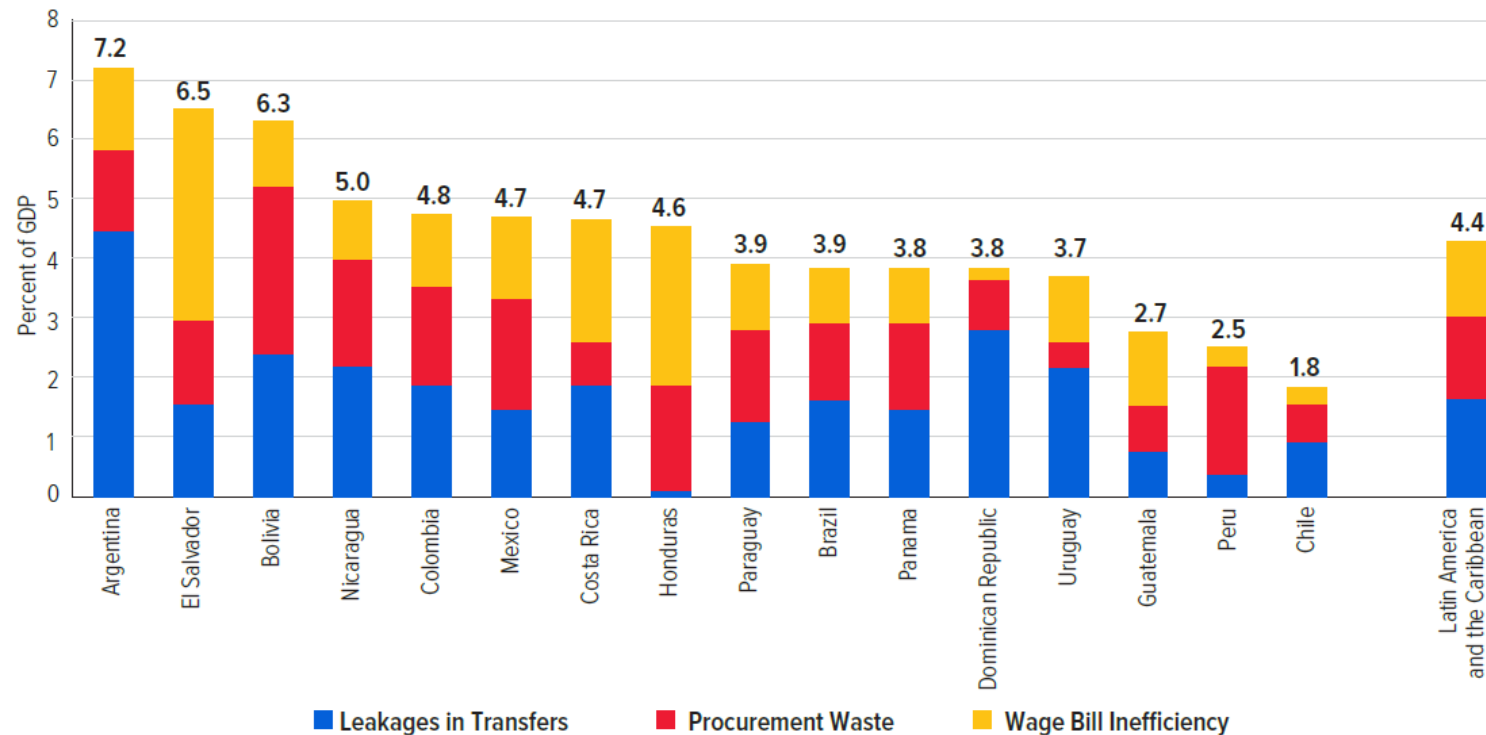
- See forthcoming flagship on Fiscal Policy



Gains in Spending Efficiency

Big Agenda on Efficiency of Gov't Spending

Figure 2.6: LAC Suffers Large Waste and Inefficiency in Public Expenditure



Procurement reforms could save 16-22% on purchases: ~1% of GDP

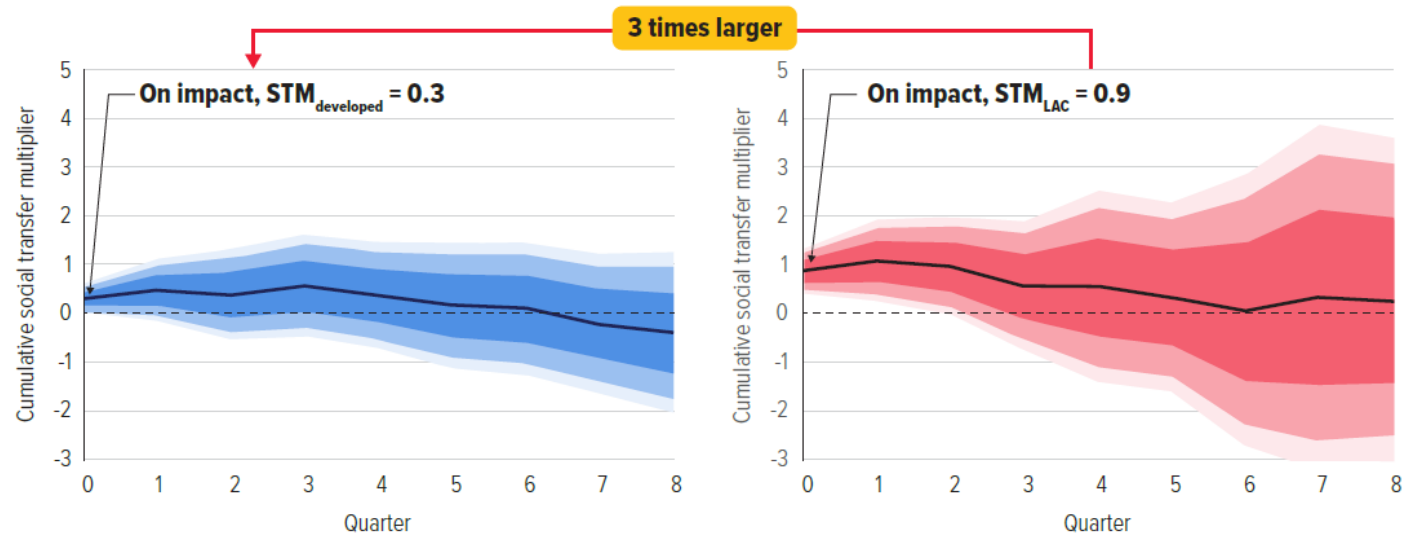
Inefficiencies in transfers (including energy subsidies and poorly targeted: 1.7% of GDP

Wages inefficiencies: 1.2% of GDP

Source: Izquierdo, Pessino, and Vuletin (2018).

Social Transfers Tend to be Growth Promoting... But Should Affect Supply Side, Too

Figure 2.13: Social transfers have three times the impact on output in LAC as in advanced countries



Source: Bracco, Galeano, Juarros, Riera-Crichton, and Vuletin (2021)

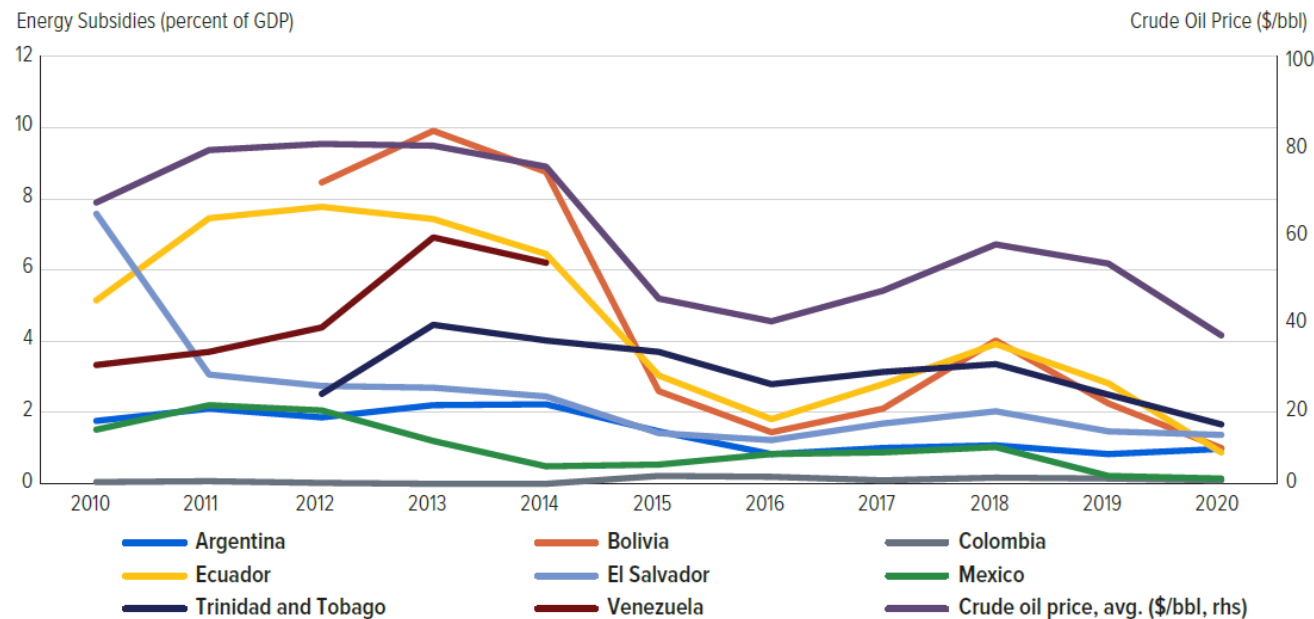
Note: The Multiplier represents currency units increase in real GDP after a one currency unit increase in real social transfers. Dark, medium, and light areas show standard errors at 68, 90, and 95 percent confidence intervals, respectively.



Rethinking Spending Priorities: 4 examples

1. Energy Subsidies Are Costly, Regressive, and ...

Figure 2.17: Energy Subsidies are High and Rise with Oil Prices



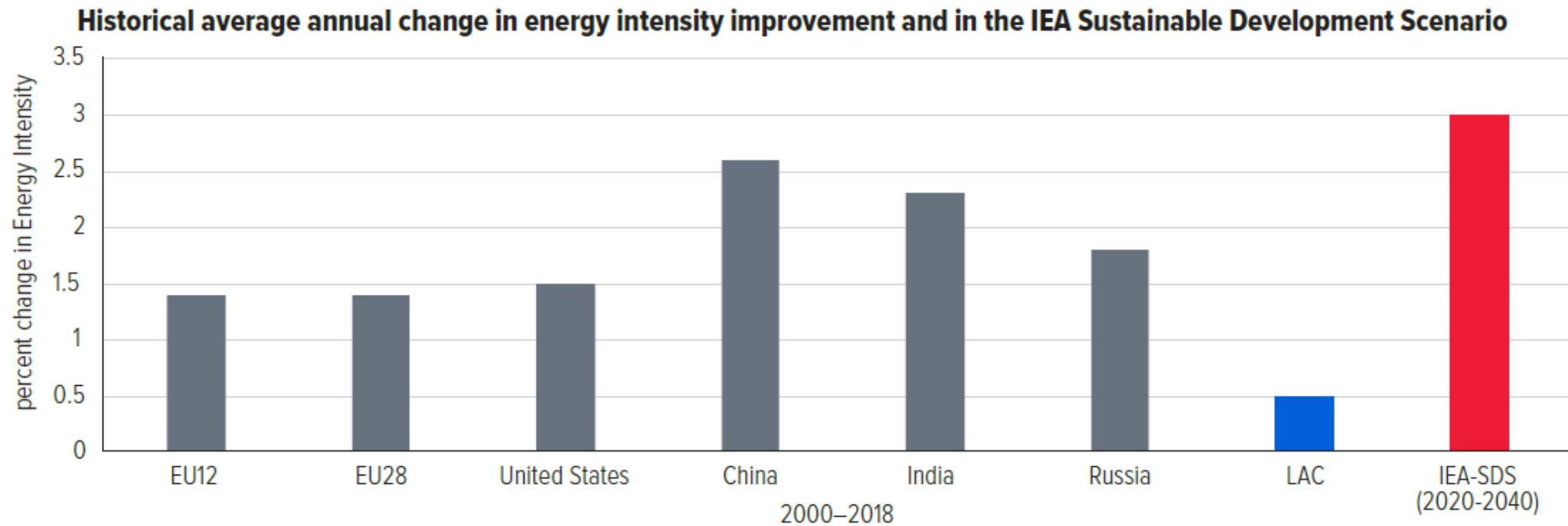
Sources: IEA Fossil Fuel Subsidies Database (2021) and World Bank.
Note: Crude oil price is the average of Brent, Dubai and West Texas

Hyper Regressive: 10-20% of Gasoline and Diesel subsidies benefit bottom 40% of population

Little progress made... fall in oil prices drove most of decline as share of GDP.

... And Impede Reductions in Energy Intensity

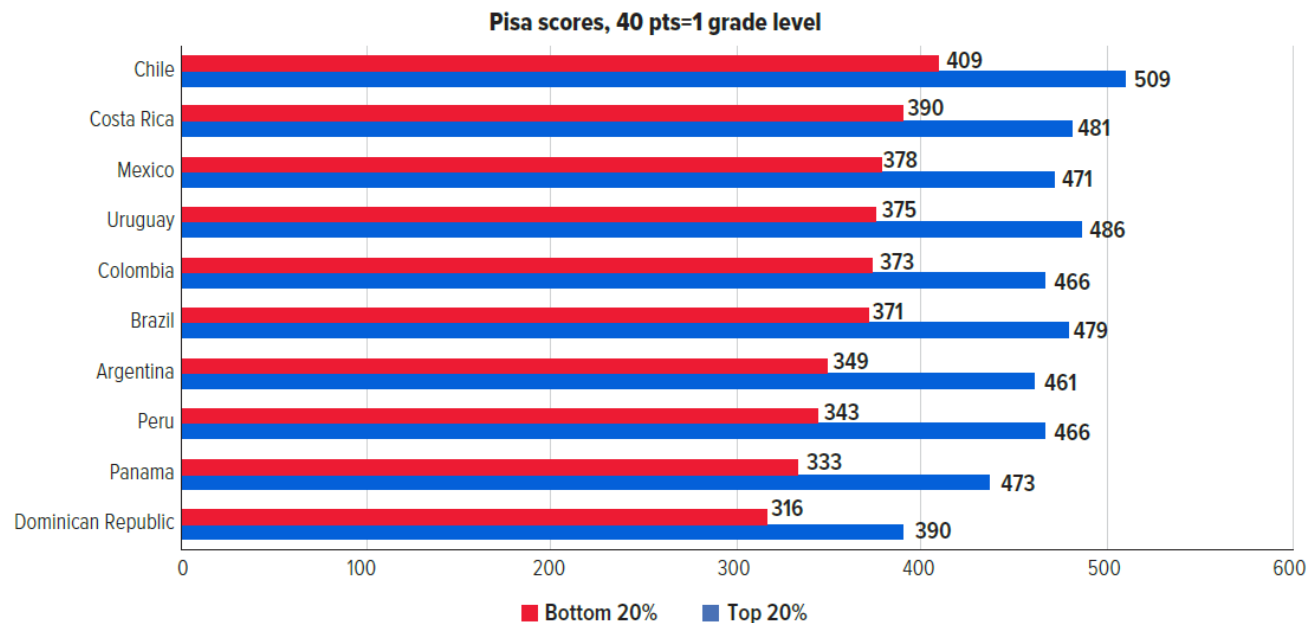
Figure 2.18: LAC Lags in Reducing Energy Intensity



Sources: International Energy Agency, World Energy Outlook 2019.

2. Smarter Spending On Education May Raise Productivity and Equity

Figure 2.8: Wide Gaps in Education Outcomes Reveal Regressive Patterns of Access and Quality



Source: World Bank (2021).

- LAC 15 year olds are 3 years behind OECD in Reading, Math and Science
- But wide disparities across income levels
- Need to recoup lost year
- Prioritize hardest hit schools
- Use technology better for teaching
And allocation of resources
- Work on raising educational leadership and accountability over medium term

LAC Spends Massively on Higher Education.. And the Private Sector Still Can't Get the Skills it Needs

Table 2.1: Higher education spending and distribution of students across fields

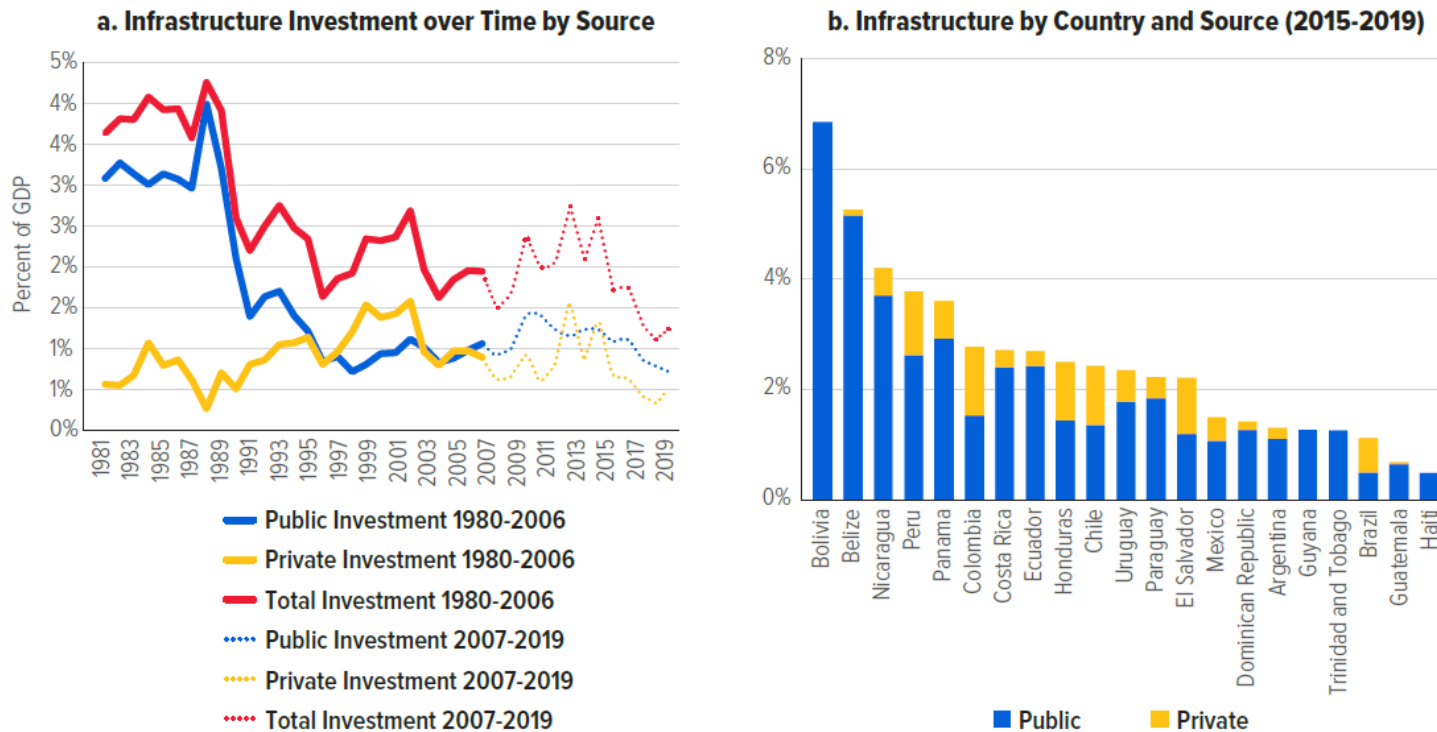
REGION	% OF GDP	% IN ENGINEERING	% IN SS, BUSINESS, LAW
LAC	1.04	13	38
ECA	0.69	20	34
EAP	0.49	22	28

Sources: UNESCO, World Bank Enterprise Surveys.

- 30% of employers in LAC report an inadequately educated workforce as a major constraint; 20 % globally.
- Yet higher education gross enrollment rate in LAC is high and LAC countries spend more resources in higher education than comparable ECA or EAP countries.
- Reallocating to Short Cycle Programs and applied fields
 - 1-3 years
 - World 25% of higher education in SCPs, LAC 9%
 - SCPs produce missing tecnicos y tecnologicos
 - Lower cost, more equitable, and better labor outcomes for poorer students. Public subsidy to Bachelors is 2-3X to SCP
 - Shift incentives to invest in scientific and applied fields.

3. Infrastructure: Will Need more Public Effort, But We Can Spend Better

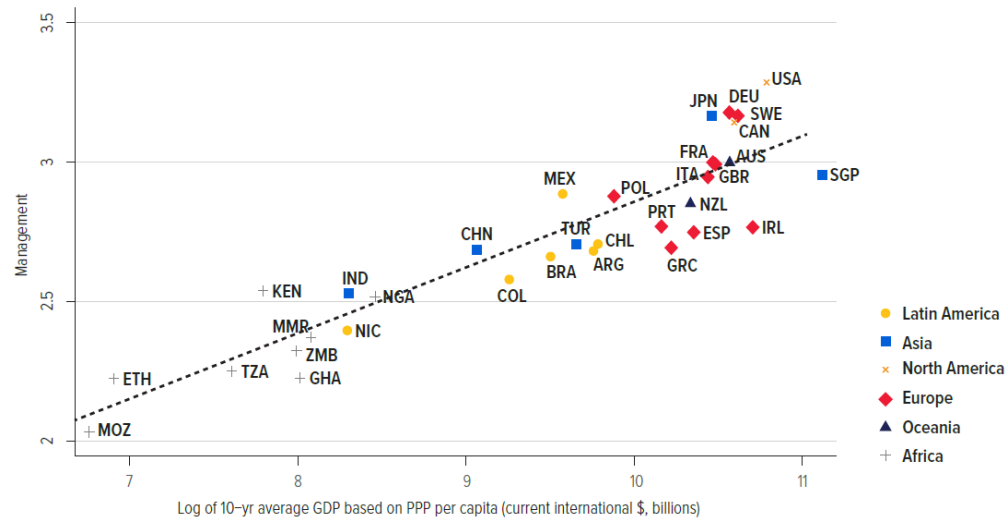
Figure 2.15: Private Sector Investment Has Not Offset the Fall in Public Infrastructure Investment



- High rates of return to infra when stock is low.
- Performance Based Contracts save ~30%
- Digital connectivity is cheap, builds resilience, and contributes to growth

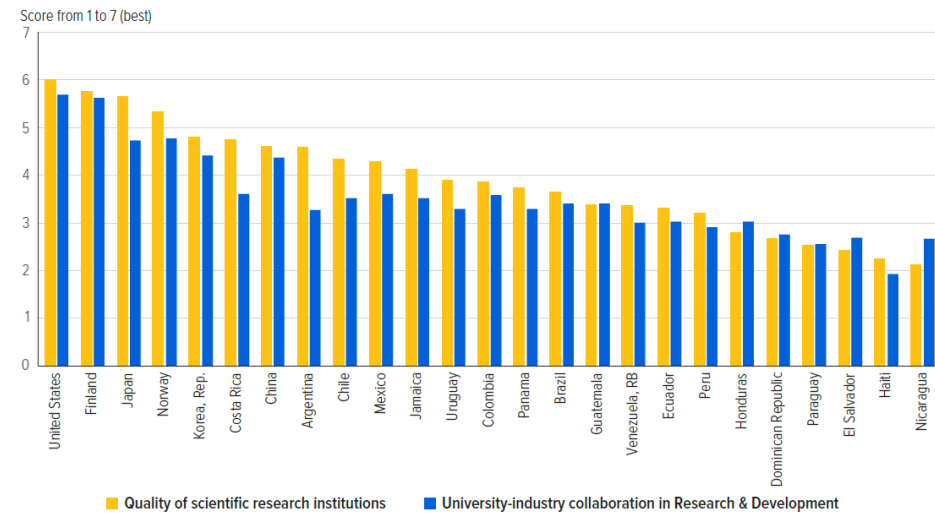
4. Spending on Innovation is Too Low and Badly Directed

Figure 2.11: LAC lags in Firm Management Practices Necessary to Innovate



Source: World Management Survey.

Figure 2.12: Subjective firm opinion of the quality of scientific research institutions and the degree of collaboration of firms with universities



Source: World Economic Forum Global Competitiveness Report 2017-2018.
Note: Score from 1 to 7 (best).

The Innovation Paradox



Developing-Country Capabilities and the Unrealized Promise of Technological Catch-Up

Xavier Cirera and William F. Maloney



Productivity Revisited



Shifting Paradigms in Analysis and Policy

Ana Paula Cusolito and William F. Maloney



High-Growth Firms



Facts, Fiction, and Policy Options for Emerging Economies

Arti Grover Goswami, Denis Medvedev, and Ellen Olafsen

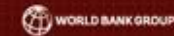


Harvesting Prosperity



Technology and Productivity Growth in Agriculture

Keith Fuglie, Madhur Gautam, Aparajita Goyal, and William F. Maloney



Soon in Spanish UNIANDES Press!!

World Bank Productivity Project

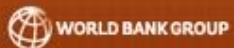
The Productivity Project: www.worldbank.org/productivity

Place, Productivity, and Prosperity



Revisiting Spatially Targeted Policies
for Regional Development

Arti Grover, Somik Lall, and William F. Maloney



At Your Service?

The Promise of Services-Led Development



Gaurav Nayyar, Mary Hallward-Driemeier, and Elwyn Davies



Fall volumes

“Fortune favors the prepared...”

Pasteur (1854)



Thank you