

HEALTHIER FIRMS FOR A STRONGER RECOVERY

*Policies to Support Business and Jobs in Latin America and
the Caribbean*



A CGD-IDB
Working Group
Report

Chairs

Andrew Powell
Liliana Rojas-Suarez

Copyright © 2022. Inter-American Development Bank (“IDB”) and the Center for Global Development (“CGD”). This work is subject to a Creative Commons license CC BY 3.0 IGO (<https://creativecommons.org/licenses/by/3.0/igo/legalcode>). The terms and conditions indicated in the URL link must be met and the respective recognition must be granted to the IDB and to CGD.

Further to section 8 of the above license, any mediation relating to disputes arising under such license shall be conducted in accordance with the WIPO Mediation Rules. Any dispute related to the use of the works of the IDB and CGD that cannot be settled amicably shall be submitted to arbitration pursuant to the United Nations Commission on International Trade Law (UNCITRAL) rules. The use of the IDB’s name for any purpose other than for attribution, and the use of IDB’s logo shall be subject to a separate written license agreement between the IDB and the user and is not authorized as part of this license.

Note that the URL link includes terms and conditions that are an integral part of this license.

The opinions expressed in this work are those of the authors and do not necessarily reflect the views of CGD, the IDB, its Board of Directors, or the countries they represent.

www.iadb.org

www.cgdev.org

Contents

Working Group Members	5
Acknowledgments	6
Acronyms	7
Executive Summary	8
1. Introduction	12
2. Firm Mortality During the Pandemic	14
Insights from Data on Bankruptcies	14
Explaining Firm Resilience	16
Government Support Programs	16
Bankruptcy Procedures	18
Data Challenges	19
Firm Creation and Mortality: The Move toward Smaller Size	20
3. Firm Performance	21
Debt and Leverage	21
Analyzing Firm Balance Sheets	23
4. Labor Market Performance	27
Participation Rates and Employment	27
Differences Across Countries and Sectors	29
Informality and Skills	30
5. Recommendations: Policies to Support Firms and Workers	32
Challenges and Opportunities for Supporting Firms	32
Alternative Support Mechanisms for Firms	32
Digitalization and New Technologies	32
New Firms and Venture Capital	32
Firm Closures, Bankruptcy, and Reorganization	33
International Firms and Multilatinas	33
Balancing Crisis Responses with Investment Considerations	33
Challenges and Opportunities for Improving Labor Markets	34
Short-Cycle Programs to Focus on Skills	34
Skills for the Digital Transformation	34
Labor Regulations to Reduce Informality and Boost Productivity	34
Recommendations	35
Create New Programs to Support Firms	35
Promote Digitalization and the Adoption of Technology	35
Boost the Entry of High-Quality Firms with High Growth Potential	36

Reform Firm Reorganization and Bankruptcy Procedures	36
Create a New Insolvency Forum.....	37
Strengthening Investment Protection.....	37
Address the Shortcomings of Short-Cycle Programs for Technical Training.....	38
Implement Policies to Boost Skills for the Digital Age.....	38
Adopt More General Labor Market Reforms.....	38
Annex. Business Support Programs in Brazil, Chile, and Colombia	39
Brazil	39
Chile.....	40
Colombia	41
References	45

Figures

Figure 1. Firm mortality and firm creation net of mortality in Bolivia, Brazil, Chile, and Peru, 2019–21.....	15
Figure 2. Number of insolvency applications in Brazil and Colombia, 2019–21.....	15
Figure 3. Size distribution of Colombian firms entering insolvency and closing, 2021.....	17
Figure 4. Firm mortality in Mexico, 2020 and 2021.....	19
Figure 5. Index of number of Brazilian firms, by size, 2017–21	20
Figure 6. Index of nonfinancial corporate debt in selected countries in Latin America, 2007–21	21
Figure 7. Kernel density of corporate leverage among firms in selected countries, 2019–21.....	22
Figure 8. Index of corporate leverage in selected countries, by sector, 2020 and 2021	23
Figure 9. Firms’ real revenues in selected countries, by sector, 2019–21.....	24
Figure 10. Firm balance sheet indicators in “recovered” and “damaged” sectors in selected countries, 2019–21...	25
Figure 11. Female and male labor participation rates in Latin America, 2020–21.....	27
Figure 12. Female and male labor participation rates in six countries in Latin America, 2019 and 2022	28
Figure 13. Output and employment in Latin America and the Caribbean, 2019–21.....	28
Figure 14. Changes in employment across sectors in Latin America and the Caribbean, 2020 and 2021	29
Figure 15. Share of population employed in selected countries, 2020–22.....	30
Figure 16. Job creation and destruction in Brazil and Colombia, by probability of automation, 2021.....	31
Figure 17. Share of informal employment in net job destruction and net job creation in selected countries	31
Figure A.1. Credit to small and medium-size enterprises, annual growth in Brazil, 2018–21.....	40
Figure A.2. Contribution of guarantee programs to annual growth of business lending in Chile, 2017–20.....	41

Tables

Table 1. Indicator of crisis preparedness of insolvency systems in selected countries in Latin America, 2022.....	18
Table A.1. Policy measures supporting firms initial and termination dates in selected countries, 2020–22	43

The CGD-IDB Working Group on Healthier Firms for a Stronger Recovery

Chairs

Andrew Powell

Principal Advisor, Inter-American Development Bank
Research Department

Liliana Rojas-Suarez

Director of the Latin America Initiative and Senior Fellow,
Center for Global Development

Working Group Members

Maria Cecilia Acevedo

Strategy Officer, IDB Invest

Jorge Alers

Emeritus Latin America and the Caribbean Region Chief
Executive Officer, Dentons

Kevin Cowan

Commissioner, Financial Market Commission (CMF), Chile

Arturo J. Galindo

Principal Economist, Inter-American Development Bank
Research Department

Marcio Garcia

Professor, Pontifical Catholic University of Rio de Janeiro
(PUC-Rio), Brazil

Pablo E. Guidotti

Professor, Torcuato Di Tella University, Argentina

Jonathan Hamilton

Partner, White & Case LLP

Ana Fernanda Maiguashca

Head, Private Council for Competitiveness, Colombia

Eric Parrado

Chief Economist and General Manager, Inter-American
Development Bank Research Department

Augusto de la Torre

Professor, Columbia University; Former Governor, Central
Bank of Ecuador

Alberto Trejos

Professor, INCAE Business School, Costa Rica

The recommendations and views expressed in this report are those of the CGD-IDB Working Group as a whole. Affiliations are for identification purposes only. Working group members participate in their individual capacity, and the views expressed should not be attributed to the institutions listed

Acknowledgments

This report is a joint work by the Center for Global Development (CGD) and the Inter-American Development Bank (IDB). The report and its recommendations are the result of the effort, collaboration, and expertise of the members of a CGD-IDB Working Group, who generously contributed their time and knowledge. The engaging discussions among Working Group members in numerous virtual meetings provided much of the content of the report. Our deep gratitude goes to Arturo Galindo and Maria Cecilia Acevedo for their tireless contribution to the drafting and overall preparation of the report. This work also benefitted from previous CGD-IDB partnerships, particularly from the [Sound Banks for Healthy Economies](#) Working Group report published in 2020.

Other external experts greatly contributed to the report. We are especially thankful for the comments provided in several meetings by Carmen Pagés and Horacio Liendo. From the IDB, Rodrigo Heresi and Daniela Villacreces prepared key data on corporate balance sheets and Miguel Benítez assisted by working on data on labor markets. Joaquin Lennon Sabatini provided additional analytical support.

Alejandro Fiorito and Carlos Guevara provided excellent assistance compiling, analyzing, and presenting data and background research. Holly Shulman, Emily Schabacker, Jeremy Gaines, and Stephanie Donohoe from CGD's communications team and Tom Sarrazin and Lina María Botero Estrada from the IDB Research Department communications team managed the editing and publication of the report as well as the outreach campaign. We are thankful to Barbara Karni for the outstanding editing work on the English version of the report, to Verónica Sardón for the translation, and to Patricia Ardila for editing the Spanish version.

Acronyms

IDB	Inter-American Development Bank
IFC	International Finance Corporation
LAC	Latin American and the Caribbean
MSMEs	micro, small, and medium enterprises
OECD	Organisation for Economic Co-operation and Development
SCP	short-cycle program
SMEs	small and medium-size enterprises

Executive Summary

This report—the product of a joint working group convened by the Center for Global Development and the Inter-American Development Bank—focuses on firms and labor markets in Latin America and the Caribbean during the COVID-19 crisis and the highly uncertain recovery phase now underway. The ongoing Russian war in Ukraine, volatility in international financial markets, and fears of global stagflation (low growth and high inflation) combine with the impacts of the pandemic to make the economic environment particularly challenging.

Through a balance sheet analysis, the report describes how larger firms have navigated the crisis by cutting back on variable costs and investment. It also focuses on small and medium-size enterprises (SMEs), which appear to have suffered more in terms of closures and restrictions on credit access. The impacts on labor markets were unprecedented, with steep falls in employment and participation rates.

A key question is whether the reallocation of resources, favoring firms in sectors that were hit less hard and able to take advantage of digital technologies, will persist. Key dangers are that informality is higher than ever, that productive resources remain trapped in small and less productive or ultimately unviable enterprises, and that firms are not rebuilding their capital stocks quickly.

Drawing on an analysis of firms and labor markets, the report provides a set of recommendations for policymakers in the region and suggestions for international financial institutions to assist productive firms to invest, support the growth of new firms, and enhance labor market performance.

UNDERSTANDING FIRM MORTALITY DURING THE PANDEMIC

Official data on firm closures and filings for insolvency reveal that business bankruptcies have been below the levels that were expected at the beginning of the pandemic. The ratio of firm failures in the formal sector in 2020-21 was similar to or even lower than prior years. In some countries, there was even greater net firm creation (net of mortality). Likewise, insolvency filings declined during the pandemic in some countries. These data appear to be at odds with surveys that indicate severe damage from the pandemic to businesses in the region. This surprising result can be explained by a number of factors:

- ▶ *Government support programs*, including government assistance to households together with credit guarantees and deferrals of loan repayments, helped firms, especially SMEs, to stay afloat during the worst of the pandemic. Although some of these programs have ended, others remain in place or have been replaced with new programs. Still, there remains uncertainty as to whether the support programs have only postponed rather than eliminated firm closures.
- ▶ *Formal bankruptcy procedures*, while improved, are cumbersome and costly, and firms may have avoided their use, seeking less formal procedures instead.
- ▶ *Lack of sufficient, high-quality data* may have resulted in an underreporting of firm closures. Informality is prevalent but in general the available data only include formal

firms. Mexico is an exception where the data include all firms and reveal much greater closures.

There is also evidence that the number of smaller firms in the region has been growing relative to larger firms. This is worrisome as productivity in the region has been stagnant and the combination of many smaller firms and high informality may lower productivity still further.

HOW ARE FIRMS EMERGING FROM THE PANDEMIC?

The revenues of listed (normally larger) firms fell by about 20 percent at the peak of the pandemic.¹ Still, by the end of 2021, revenues had fully recovered in some sectors (mining; oil and gas extraction; agriculture, forestry, and fishing; and higher-capital-intensity manufacturing). In contrast, revenues remained significantly below pre-pandemic levels in several other sectors (professional services; business services; retail trade; transportation excluding air transport; air transport; health, legal, education, and social services; communications; construction; wholesale trade; hotels and restaurants; amusement and museums; and other sectors).

As might be expected, the profits of firms in the recovered sectors returned to positive territory by the end of 2021, while profits in the *damaged* sectors were still around 20 percent lower than before the pandemic. The analysis uncovers significant scarring in firms left by the pandemic.

First, investment in the region fell sharply, rebounding only recently, mostly in the recovered sectors. In both the recovered and damaged sectors, a significant amount of cumulative investment was sacrificed, as reflected in the decline in fixed assets, which have remained depressed. As fixed assets are normally considered firms' productive assets, this decline will likely restrict output going forward.

Second, costs fell across sectors and remain depressed in the damaged group, likely reflecting lower labor costs and the adverse impact on the demand for formal workers.

Third, while debt rose during the pandemic, the proceeds were used to build higher cash reserves rather than to finance real investment. Those cash reserves have since been depleted, likely to pay down debt, which has now fallen back to pre-pandemic levels.

How can firms finance investment going forward and bring the capital stock back to at least pre-pandemic levels? Given the current volatile international capital markets, increasing global interest rates, and concerns about a global recession, it is unlikely that firm revenues will continue to rise well above pre-pandemic levels or that firms will be in a strong position to raise more debt or attract more direct investment in the form of equity. Failing a robust policy response, it may take considerable time to replace the capital stock lost as a result of the crisis, limiting growth prospects in the region.

LABOR MARKET PERFORMANCE

Labor markets were deeply impacted by the pandemic with steep falls in employment and in participation rates. Unlike previous recessions, informal employment fell by more than formal employment. During the recovery, employment came back more slowly than economic activity. While employment across the region has now returned to close to pre-pandemic levels, it remains below pre-pandemic trends and there is considerable variation across countries and sectors. Informal employment returned more strongly than jobs in the formal sector, and informality is now higher than before the crisis. Female employment lagged as did female participation rates, which remain lower than before the pandemic.

The pandemic exacerbated structural challenges facing labor markets in the region. High informality lowers productivity, reduces the incentives to acquire skills, and shrinks the tax base. Lower female employment heightens inequality and lowers the potential output of the region.

In addition, the pandemic appears to have accelerated the trend towards digitalization and yet the region may not be able

¹ Revenues here refers to the real revenues of the median firm in local currency.

to take full advantage of this trend owing to inadequate digital infrastructure and a shortage of workers with the right skills.

RECOMMENDATIONS

To help countries in the region overcome these challenges, the report provides a set of recommendations to support firms and enhance labor market performance:

Create New Programs to Support Firms

Countries should consider creating a public-private institution with a limited time mandate and a professional staff hired largely from the private sector to support firms with strong growth potential. The institution—which could take various forms, such as a fiduciary fund—would evaluate and develop techniques for identifying firms with good business prospects and provide support through a range of instruments including equity injections. The governance structure of the institution should ensure that it would be independent from political influence in lending decisions. IDB Invest and/or the IFC could advise on the institutional design and provide resources as appropriate. The institution would have its own resources and provide expertise to strengthen corporate governance. The capital injections could lead to an initial public offering on the country's stock exchange, widening the capital base of the firm and providing funds for the public-private institution to exit. In some cases, capital injections could be used to facilitate consolidation in affected sectors. The institution should aim to be profitable and, apart from initial financing, not require fiscal support. It would be critical to hire a high-quality team and ensure that the institution worked professionally and independently.

Boost the Entry of High-Quality Firms with High Growth Potential

Countries should consider supporting improved access to venture capital through international networks or the development of a local market.

Reform Firm Reorganization and Bankruptcy Procedures

Countries should consider reforms to improve formal insolvency codes, following five broad principles: flexibility, transparency, debtor-in-possession financing, human capital expertise, and procedural efficiency.

Create a New Insolvency Forum

Regional integration and more frequent cross-border issues within insolvency procedures, coupled with the lack of national expertise particularly in smaller countries, call for the creation of a new forum to provide technical support to enhance national firm resolution processes. The forum would assist national authorities to develop robust, reliable, and more standardized firm insolvency procedures across the region while at the same time allowing national rules to have greater flexibility. The forum would seek to avoid or reduce conflicts, ring-fencing of assets, and other inefficiencies.

Strengthen Investment Protection

Many existing investment protection systems provide mechanisms to facilitate consultations between countries and investors to advance common aims and avoid disputes, striking a balance between immediate concerns in the context of a crisis such as the pandemic and the longer-term goal of attracting stable and productive foreign investment. When available, these systems should be used. Where such systems are absent, countries should develop new mechanisms to facilitate substantive and transparent consultations.

Promote Digitalization and Technology Adoption

To prevent the region from falling farther behind in the adoption of digital technologies, countries should develop an explicit digitalization strategy. The strategy could include investment in digital infrastructure, incentives for firms to digitalize, and robust systems for digital identities, cybersecurity, and data protection. In addition, training schemes to boost the skills needed to support the digital transformation should be developed; such training could be subsidized through vouchers or tax incentives.

Improve Short-Cycle Programs for Technical Training

Short-cycle programs for technical training can play a particularly useful role in the current context but existing programs fall short of meeting this potential. Countries could improve short-cycle programs by developing better information systems, enhancing oversight and monitoring, creating flexible pathways between these programs and more traditional degree or certification programs, and providing scholarships to students from poorer households.

Adopt More General Labor Market Reforms

Countries should consider more general labor market reforms, including a concerted effort to reduce informality. Reducing hiring costs for formal jobs by financing social security and health benefits from more general taxation and reducing labor taxes would decrease the incentives for informality. Well-designed savings or insurance schemes could support workers through periods of unemployment and rather than protecting jobs, protecting mobility would enhance efficiency. Policies to support female employment should also be considered, such as boosting the provision of preschool education and care for seniors and the ill. Reforms should be tailored to country circumstances and international financial institutions are well-qualified to provide advice on the relevant specific labor market interventions.

Introduction

The COVID-19 pandemic has had severe impacts on firms and labor markets in Latin America and the Caribbean. In 2020, when revenues and profits collapsed, firms cut costs and borrowed to build up liquidity to survive the crisis. Some sectors bounced back relatively quickly and benefitted from the rapid adoption of new and digital technologies; for others, the shock has been more persistent and may reflect a permanent reallocation across sectors. Despite the size of the shock, reported closures of formal firms have been relatively limited, however, although concern remains that solvency problems may not yet have fully materialized.

The shock for labor markets was unprecedented. Instead of providing a buffer, as in previous crises, employment in the informal sector fell by more than in the formal sector. Employment has come back, with variations across countries, but unemployment remains higher than before the crisis, and the effects have been more persistent for women and younger workers. Informal employment rebounded strongly and now exceeds pre-crisis levels in several countries, but participation rates remain below pre-crisis levels.

Government support packages, coordinated closely with central bank monetary policy, liquidity injections, and flexibility in financial sector supervision, helped firms and households survive during the crisis.² That support may partly explain the relatively low numbers of formal firm closures. Public sector debt has risen as a result, and monetary policy has now

tightened in many countries in the region to combat higher inflation.

Policymakers face a challenging environment. The fight against COVID-19 is not over; surges from new variants may warrant restrictions that will affect economic activity across different sectors. Russia's war in Ukraine is having strong effects on the global economy, with increases in commodity prices that may benefit exporters but have a negative impact particularly on oil importers and on global growth, depressing economic activity in the region. Monetary policy normalization in the United States and elsewhere has heightened volatility in financial markets and capital flows and will increase the cost of financing. Global economic prospects have deteriorated, and the risk of stagflation (low growth and high inflation) has risen. Uncertainty regarding the persistent impacts of the pandemic and how the war in Ukraine will unfold complicate the policy-making environment. Also, it is often hard for firms to determine which impacts may be temporary and which may represent permanent shifts.³

The COVID-19 crisis accelerated the trend toward digitalization, and there is some early evidence that job losses were larger in jobs susceptible to automation. But the impact on employment remains an open question. Technology may displace labor from some tasks, but it may also create more jobs elsewhere.

2 In Chile, for example, the Comisión de Mercados Financieros issued guidelines to consider the medium-term effects of asset deterioration for different types of financial institutions consistent with International Reporting Financial Standards (IFRS), particularly IFRS9, in an attempt to avoid a short-term reaction that might have provoked excess procyclicality.

3 See [Cavallo et al. \(2022\)](#) for an analysis and recommendations for policymakers.

There are concerns about how well firms in the region are placed to take advantage of such new technologies. While there is considerable heterogeneity across sectors, debt levels among larger firms rose and investment fell during the peak of the pandemic. Although, more recently, debt levels have broadly fallen, fixed assets remain well below pre-crisis levels. Moreover, measures of distance to default have shrunk, as market valuations have suffered, and volatility remains elevated, given the level of economic uncertainty. Although larger listed firms are cash-rich, they may need those resources to confront debt-servicing needs; firms may not be in a position to finance significant new investments, especially investments that move them swiftly into the new digital age.⁴

Although larger listed firms account for most private investment, the region has a long tail of smaller and owner-operated firms, which fared less well through the peak of the pandemic crisis. Such firms faced more financial problems, were more likely to fall into arrears, and experienced a larger proportion of closures. Still, the number of small firms seeking protection from creditors through formal bankruptcy procedures appears to be surprisingly low; however, many small firms, particularly the informal ones, may simply have stopped operating. As such firms tend to have very little capital, they may be more flexible and may begin to operate again relatively easily. The strong rise in informal employment suggests a comeback for owner-operated and informal firms. Although their comeback could support job recovery, these firms are not

well placed to take advantage of new and digital technologies and tend to have low productivity. The recovery process from COVID-19 has not helped resolve the long-standing structural problems facing the region of a poor allocation of resources leading to low productivity and low growth.

This report focuses on firms and labor markets during the crisis and the highly uncertain and challenging recovery phase. It seeks to understand how so many larger firms managed to survive and whether there are policy levers that may help such firms navigate the current levels of uncertainty. The report also focuses on small and medium-size enterprises (SMEs) and how policies might be best shaped to provide incentives for sound SMEs to grow into successful medium-size and large firms and provide good jobs in the future. Toward this end, the report reviews developments in labor markets. A key question is whether reallocation will be persistent. A danger is that given deficiencies in the allocative function of markets, particularly labor markets, productive resources may remain trapped in less productive or ultimately unviable enterprises. A comprehensive account of labor market challenges was beyond the scope of the working group responsible for this report, which therefore focuses on selected key issues. On the basis of these analyses, the report provides a set of recommendations for policymakers in the region and suggestions for multilateral financial institutions to enhance firm recovery, economic growth, and employment.

4 See Heresi and Powell (forthcoming) on the debt levels of listed firms and how debt and distance to default interact to affect investment. They argue for a refined definition of the problem of a debt overhang, suggesting to use debt levels and other firm characteristics (particularly those summarized in the distance to default measure). They conclude that investment may suffer as a result of the COVID crisis and high levels of uncertainty.

Firm Mortality During the Pandemic

In the earlier phase of COVID-19, the United Nations Economic Commission for Latin America and the Caribbean estimated that almost 3 million, or 19 percent, of firms in the formal sector would close because of the pandemic, most of them small enterprises (ECLAC 2020). This section analyzes data on firm mortality and firm creation. The data is not standardized, and the quality varies across countries creating challenges. Still, using the available information, a set of interesting patterns become apparent.

INSIGHTS FROM DATA ON BANKRUPTCIES

These problems notwithstanding, databases from official sources in Brazil, Bolivia, Chile, Colombia, Mexico, and Peru provide insights into the extent of reported firm failures in 2020–21. Data on registered firms suggest that the number of business bankruptcies was lower than expected at the beginning of the pandemic. Indeed, in most of the countries studied, the indicators of firm failures in the formal sector were lower in 2020–21 than in 2019.

Comparable data on firm mortality and net creation are available for Bolivia, Brazil, Chile, and Peru (figure 1).⁵ Firm

mortality varied across these countries. It was high before the pandemic in both Brazil and Chile (panel a). In Chile, it jumped in 2020. In Brazil, it fell in 2020 but rose in 2021. In Bolivia and Peru, there was no rise in firm exits; if anything, mortality fell.⁶ Net firm creation (firm creation net of firm mortality) was positive in Bolivia, Brazil, and Peru (panel b).⁷ It is difficult to disentangle the impacts of the pandemic from the many policy measures that were introduced to support businesses and households, but in general there is no strong pattern of increased firm mortality in these countries.

Data for firm insolvency filings in Brazil and Colombia paint a similar picture. In Colombia, the number of applications remained practically unchanged in 2020 relative to 2019; in Brazil, the value actually decreased. Data for 2021 present a similar pattern (figure 2).

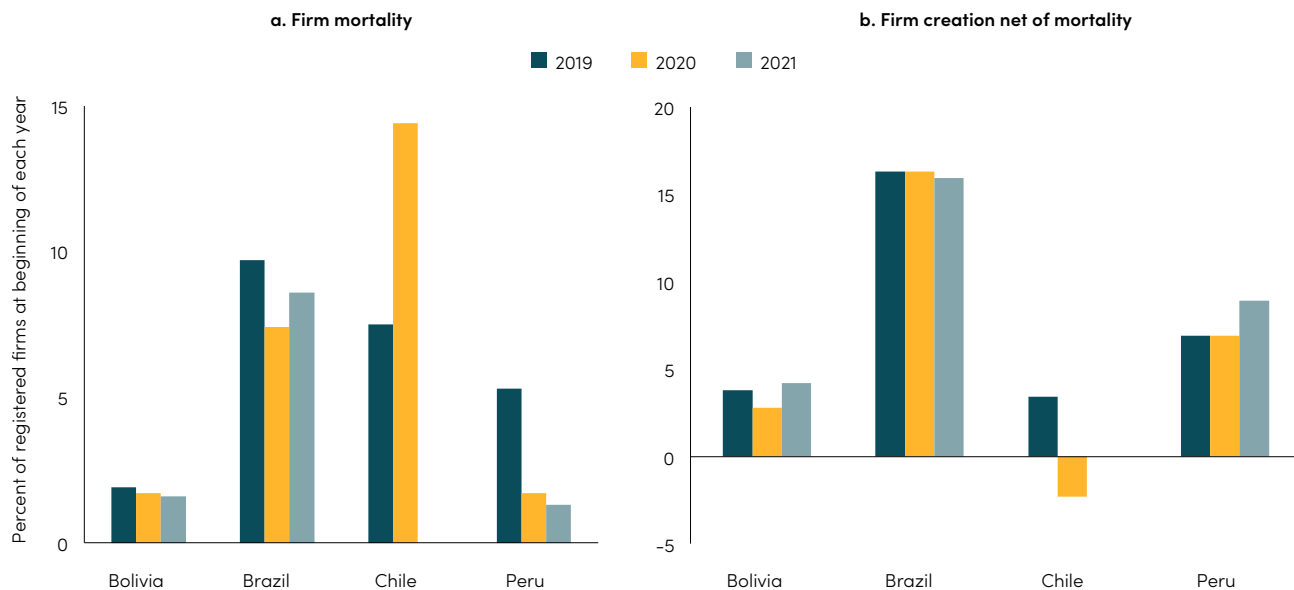
These data appear to be at odds with surveys and perceptions of the severe damage the pandemic has inflicted on businesses. For example, firm-level surveys from Central America that include SMEs suggest that about a quarter of businesses in the region could permanently close—a much larger share than the average 14 percent in other emerging economies (World Bank 2020, 2021).

5 For Colombia, there are comparable data for firm creation but not for firm mortality.

6 Caution needs to be taken when interpreting the data for Peru, for several reasons. First, the absolute number of reported firm closures fell since the beginning of the pandemic, suggesting underreporting. Second, the data do not include businesses owned by individuals (*personas jurídicas*). Including individually owned businesses would increase firm mortality. A lower-bound estimate raises the share of firms that died to 5.6 percent in 2019, 7.1 percent in 2020, and 2.8 percent in 2021.

7 The numbers in Brazil may partly reflect the sharp reduction in the time it takes to open a firm, which fell from 5 days and 9 hours in January 2019 to 2 days in December 2021 (<https://www.gov.br/governodigital/pt-br/mapa-de-empresas/boletins/mapa-de-empresas-boletim-do-3o-quadrimestre-de-2021.pdf>).

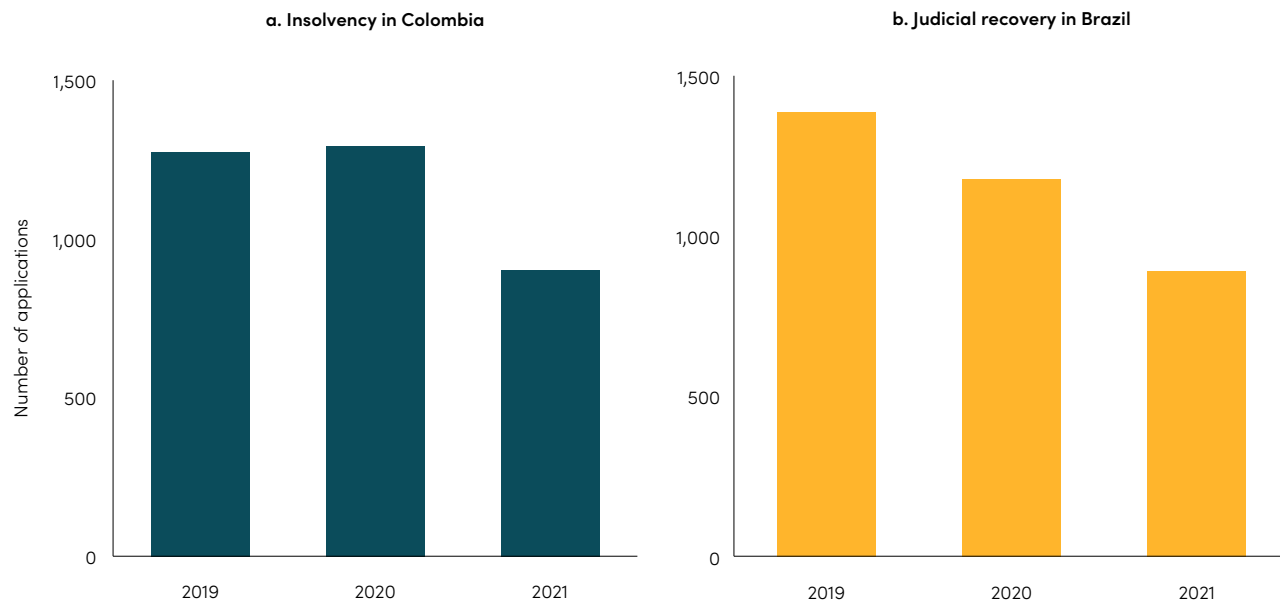
FIGURE 1 Firm mortality and firm creation net of mortality in Bolivia, Brazil, Chile, and Peru, 2019–21



Sources: [Fundempresa](#) for Bolivia, [Painel Mapa de Empresas](#) (Ministério da Economia, Finance Ministry) for Brazil, [Servicio de Impuestos Internos](#) (Tax Authority) for Chile, and [Instituto Nacional de Estadística e Informática](#) (INEI, National Statistical Institute) for Peru.

Note: firm mortality is measured as the number of firms that closed in year t over the total number of existing firms at the end of year $t-1$. Equivalent calculations are used to estimate firm creation net of mortality. Data are for December of each year. There are no data for Chile in 2021.

FIGURE 2 Number of insolvency applications in Brazil and Colombia, 2019–21



Sources: [Central Bank of Brazil](#) and [Superintendencia de Sociedades](#) (Superintendency of Companies) for Colombia.

Note: Data for 2021 end in December for Brazil and September for Colombia. The insolvency regime in Brazil gives companies time for debt restructuring, protecting them from most creditors during an automatic stay period. The insolvency regime in Colombia allows individuals and firms to reach repayment agreements with their creditors regarding outstanding obligations. Alternatively, firms can liquidate their business through a judicial process.

EXPLAINING FIRM RESILIENCE

A number of factors may explain lower than expected reported closures and business filings. The seemingly anomalous findings might reflect the effects of supportive financial policies (IMF 2021), other means of firm reorganization that avoided formal and costly bankruptcy procedures, and/or data challenges that do not allow the accurate tracking of closures.

Government Support Programs

Countries in the region mobilized sizable fiscal resources to address the health crisis and provide economic relief, with the average fiscal package across countries equal to about 8.5 percent of GDP. This amount sits well below that of advanced economies (19 percent of GDP on average) and masks considerable heterogeneity within the region. Packages were particularly large in Brazil, Chile, and Peru; they were more modest in Central America and the Caribbean (Cavallo and Powell 2021). Two-thirds of countries had fiscal packages of 3 percent of GDP or less.

The extraordinary fiscal stimulus of 2020 has partially ended, with significant differences across countries. The reduction of government support measures will have implications for firms; some governments may also provide a new suite of measures during the recovery. The impact of these policy changes will probably be heterogenous for firms, depending on size, sector, and other factors of firm vulnerability.

Governments in the region implemented at least 134 measures directly aimed at supporting SMEs (World Bank 2022). More than 43 percent of these measures are concentrated in three categories: debt finance support, employment cost support, and tax support. Other measures—including income support to families, monetary policy actions, and general fiscal support aimed at tackling corporate vulnerabilities—also helped firms survive the crisis. (The annex describes some of the features of the policy support programs in selected

countries; table A.1 provides support program termination dates.)

Among government support measures, those that linked the corporate sector and the financial system stand out for their, yet unknown, full effects on firms' future closures. The two salient measures in this category are loan moratoria and credit guarantees.

Loan moratoria, defined as a deferral of loan repayments, have been extensively used in the region. In some countries, moratoria were voluntary, with country authorities encouraging banks to reprogram loans with grace periods and longer maturities for repayment. In other countries, governments mandated loan deferrals. In some cases, banking supervisors provided incentives by loosening banks' provisioning requirements, implying that banks could report loans subject to moratoria as performing and were not required to set aside additional provisions for potentially greater future losses.⁸

The status of payment deferral programs and changes to loan classification and provisioning requirements varies significantly across countries. In some countries, these programs have been discontinued; in others, they may remain active.⁹ Where moratoria and/or regulatory forbearance are still in place, the risk is that a large number of firms may be sitting on a stock of debt that they will not be able to repay when programs end. If this problem is sufficiently large, the build-up of nonperforming loans may also have significant adverse effects on banks' balance sheets. Some banks have increased provisioning in anticipation of such issues. Given the high levels of economic uncertainty, it remains difficult to gauge the extent of these risks.

Many countries also implemented credit guarantees programs. Such programs were particularly large in Chile and Peru, but also in Colombia and Brazil. Guarantees have been especially relevant for SMEs and may have helped contain the

8 For a discussion of the impact of loan moratoria, regulatory forbearance, and credit guarantee programs on the stability of financial systems in the region, see Powell and Rojas-Suarez (2020).

9 Brazil, Chile, Colombia, Mexico, and Peru have phased out changes to asset classification, valuation, and provisioning. Brazil and Colombia have ended other banking sector measures, such as the use of flexible capital buffers. In Chile, the large balance sheet expansion of the central bank has not yet shrunk significantly. It seems likely that the credit provided to banks, which was of two to three years' maturity, will remain until those contracts expire.

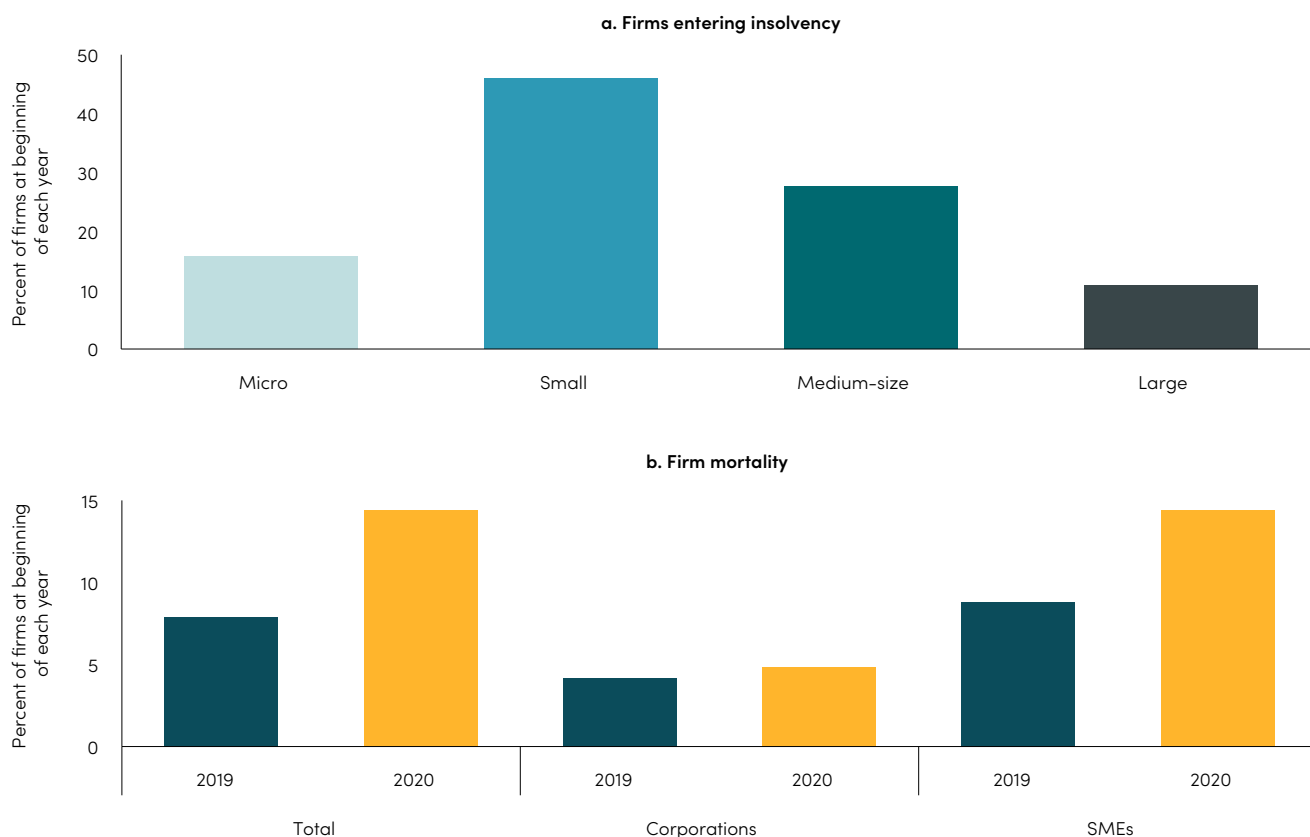
already large number of small firm closures. Indeed, SMEs and microenterprises in Colombia represented almost 90 percent of the firms that started bankruptcy procedures in 2021; SMEs appear to have accounted for the lion's share of closures in 2021 (figure 3).

The status of credit guarantee programs also varied across countries.¹⁰ In some countries (Chile and Peru¹¹), new programs replaced the original one. Several governments changed the design of these programs during the pandemic to provide banks with incentives for take-up and better reach smaller firms (see the annex).

The timing and speed for further changes and termination of these programs will need special attention, especially in a context in which the global effects of the war in Ukraine are contributing to even weaker growth dynamics in the region than expected at the beginning of 2022. Low growth will, in turn, slow the expansion of credit.

In these post-pandemic circumstances, increased credit risk on top of the already fragile status of many firms as a result of COVID-19 may have two effects. First, it may discourage banks from using credit guarantees to lend to firms in general and particularly to SMEs, which are riskier than larger firms. Lack of credit could increase mortality among small firms.¹²

FIGURE 3 Size distribution of Colombian firms entering insolvency and closing, 2021



Source: [Superintendencia de Sociedades](#) (Superintendency of Companies).

10 Mexico's government did not implement a credit guarantee program. In Peru, the original guarantee program, Reactiva Peru, expired in November 2020; the PAE-MYPE program, a guarantee for SMEs, expired March 31, 2022 (COFIDE 2022).

11 See the annex for a summary of the evolution of the guarantee program in Chile.

12 A February 2022 Standard & Poor's [report](#) underscored the risks for the SME sector in the context of expected weak economic performance despite continuing government guarantee programs.

Second, unfavorable economic prospects may lead to increased loan defaults by firms that benefitted from these instruments, triggering banks to call on the guarantees, with adverse effects on fiscal balances.¹³ Governments' responses to the COVID-19 crisis resulted in a significant increase in public sector debt. Governments will have to assess difficult trade-offs to maintain fiscal sustainability while promoting economic recovery.

Uncertainty thus remains as to whether government support to firms only postponed rather than eliminated the failure of a significant number of firms, especially smaller ones.

Bankruptcy Procedures

Costly, cumbersome, and/or poorly designed bankruptcy and insolvency procedures constrain firms from seeking legal resolution to their problems in times of acute stress. Although bankruptcy and insolvency regimes improved in the region over the last 15–20 years, central issues remain. An IMF paper (Araujo et al. 2022) presents an indicator that aims to “capture the features in an insolvency system that increase the ability of such systems to address a corporate debt crisis.”

There is wide diversity in the preparedness of insolvency regimes in the region (table 1). In Colombia, for example, the value of the indicator (69.9) is even higher than the median value for advanced economies (67.1). In contrast, the indicator is very low for the Central American countries in the sample.

TABLE 1 Indicator of crisis preparedness of insolvency systems in selected countries in Latin America, 2022

COUNTRY	CRISIS PREPAREDNESS OF INSOLVENCY SYSTEM
Colombia	69.9
Brazil	57
Chile	52
Argentina	49.1
Mexico	41.1
Honduras	26.8
Nicaragua	18.5
Median for advanced economies	67.1

Source: Araujo et al. 2022.

Note: The value of the indicator ranges from 0 to 100, with higher scores denoting better preparedness.

Given that improvement in insolvency and bankruptcy frameworks almost always requires changes across multiple bodies of legislation, adjusting them may be challenging. Critical challenges in bankruptcy procedures exist in the following areas:

- ▶ The pandemic has affected concession contracts involving states or state entities across a range of sectors, giving rise in many instances to rights or remedies under contract or applicable law. For example, “economic equilibrium clauses” allow parties to negotiate and restructure a contract to allow the concession to continue to function. However, discrepancies emerged in some cases between government responses to the pandemic and the provisions of state contracts, creating economic and legal impacts and solvency risks for some firms.

¹³ In most countries, guarantee funds are pre-funded to some degree. It is not clear whether such funding is meant to reflect the expected losses or the expected plus the unexpected losses up to some estimated statistical tolerance value of these programs. See Bolzico et al. (2022a) for a discussion.

- ▶ Cramdown—a process that allows a court to require all creditors to accept a firm’s bankruptcy reorganization agreement reached with only a qualified majority of creditors—is not easy to implement, because in many countries, certain creditors (workers, for example) are not subject to this imposition, and liabilities to labor can be significant.
- ▶ In several Latin American countries, a “stay”—whereby creditors are precluded from pursuing their legal claims bilaterally once a firm has applied for bankruptcy or reorganization proceedings—cannot be fully implemented. For example, labor claims are not subject to a stay. In addition, when granting a loan to an enterprise, creditors often require collateral from the enterprise owners; if the enterprise files for bankruptcy or reorganization, such creditors are not bound by the stay and can still attempt to seize the assets, deterring shareholders from seeking bankruptcy protections.
- ▶ Effective bankruptcy procedures may require changes in social norms to implement. In some countries, there is a presumption (even within the judicial system) that a bankruptcy must imply some type of fraud or illegal activity and that the firm’s owners and/or managers should be subject to criminal punishment.
- ▶ With foreign investment, competing bankruptcy proceedings, technical issues between different local jurisdictions, and legislation that is ancillary to what is going on in other jurisdictions are common.
- ▶ The roles of the state and the private sector are not always well defined in the legislation of different jurisdictions.
- ▶ Complementary to domestic insolvency procedures that need to be improved, potential changes to bilateral treaties for investment protection need to be assessed.

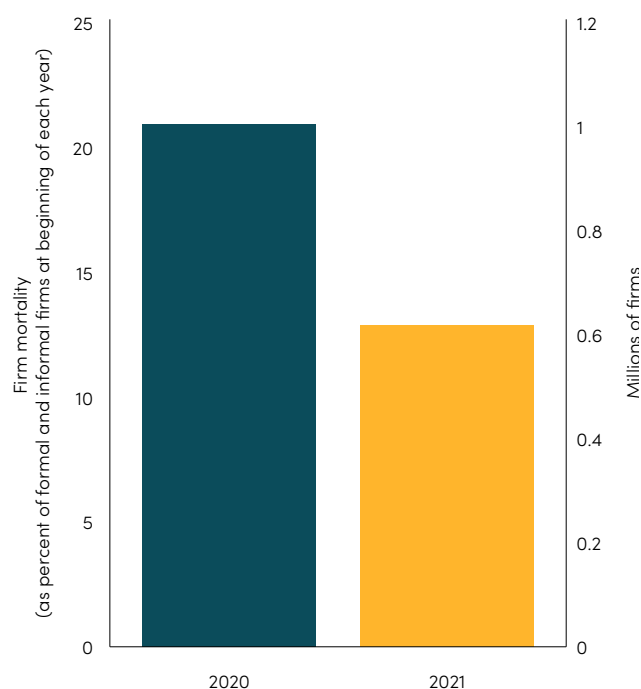
An additional overarching issue is that most Latin American legal systems are based on civil law. Although this system has the advantage of predictability, it lacks flexibility for dealing

with insolvencies—at a time when flexible mechanisms to resolve firms’ problems promptly are needed the most.

Data Challenges

Assessing the extent of firm closures is difficult, because of the lack of sufficient data and problems with the quality of the data. Most data include only the formal sector, in a region where firm informality is prevalent. A notable exception is Mexico, where the government reports the closures of firms in both the formal and informal sectors. Including closures in the informal sector greatly increase the number of firms closures: when accounting for informality, about 20 percent of firms closed in Mexico in 2020. By October 2021, an additional 13 percent of the already reduced number of firms ceased to operate (figure 4).¹⁴ Mexico’s experience suggests that the total number of firm closures in countries with very high levels of informality (such as Bolivia and Peru) is much higher than those reported in official statistics.

FIGURE 4 Firm mortality in Mexico, 2020 and 2021



Source: Instituto Nacional de Estadística y Geografía (National Institute of Statistics and Geography, INEGI).

Note: Data for 2021 end in October.

¹⁴ In Mexico, 23 percent of firms in the formal sector and 32 percent of firms in informal sector died between May 2019 and July 2021. This difference is evident across sectors.

FIRM CREATION AND MORTALITY: THE MOVE TOWARD SMALLER SIZE

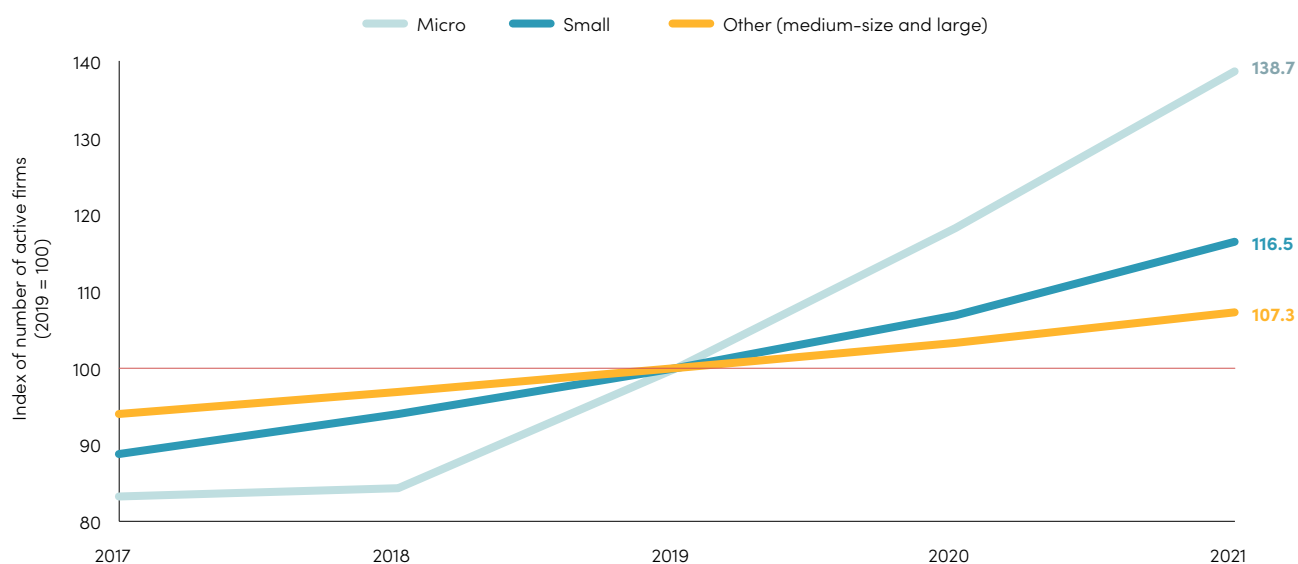
Despite greater firm mortality among smaller firms than larger ones, there is some evidence that firm creation during the pandemic has been biased toward smaller business units in a number of countries (Rojas-Suarez and Fiorito 2022). Brazil continued to experience strong firm creation during the pandemic, but the expansion of firms was driven by microenterprises (figure 5). The number of microenterprises in Brazil was 38 percent higher in 2021 than in 2019, a much larger rate of expansion than experienced by larger firms. In a country where microenterprises already accounted for 95 percent of total firms, the pandemic increase the share of the smallest productive units.

Data for Chile¹⁵ and Colombia¹⁶ confirm these trends. The evidence from Chile suggests that the amount of capital invested

in the average new firm created during the economic recovery was smaller than during the pre-pandemic period, whether capital is measured in local currency, dollars, or in real terms. Splitting the data by firm size, both smaller firms (*empresa individual de responsabilidad limitada*) and larger companies (*sociedades por acciones and sociedades anónimas*) were created with less start-up capital in 2021 than during the pre-pandemic period.¹⁷

Firms in the region were already quite small before the pandemic. In 2019, medium-size firms (firms with 11–100 employees) employed 14 percent of total workers—far fewer than in the United States, where they employed 23 percent (Meléndez 2022). This difference was even larger for firms with more than 101 employees, which employed 18 percent of all workers in the region and 56 percent in the United States. The proliferation of firms of small size does not support productivity in the region, which was already in decline before the pandemic.

FIGURE 5 Index of number of Brazilian firms, by size, 2017–21



Source: Painel Mapa de Empresas.

15 In Chile, the fastest growth in 2020 was among microenterprises, which grew by 3.2 percent, a much higher rate of growth than the historical average of 2 percent between 2006 and 2009.

16 In Colombia, even though registration of new business units in 2021 grew by 40.0 percent among large firms and just 10.6 percent among microenterprises, microenterprises contributed more than 90 percent of new business unit creation (Confecámaras, 2022).

17 Start-up capital in the median firm recovered its 2019 value in 2021, but it has experienced a decreasing trend since 2013, according to data from Chile's Servicio de Impuestos Internos.

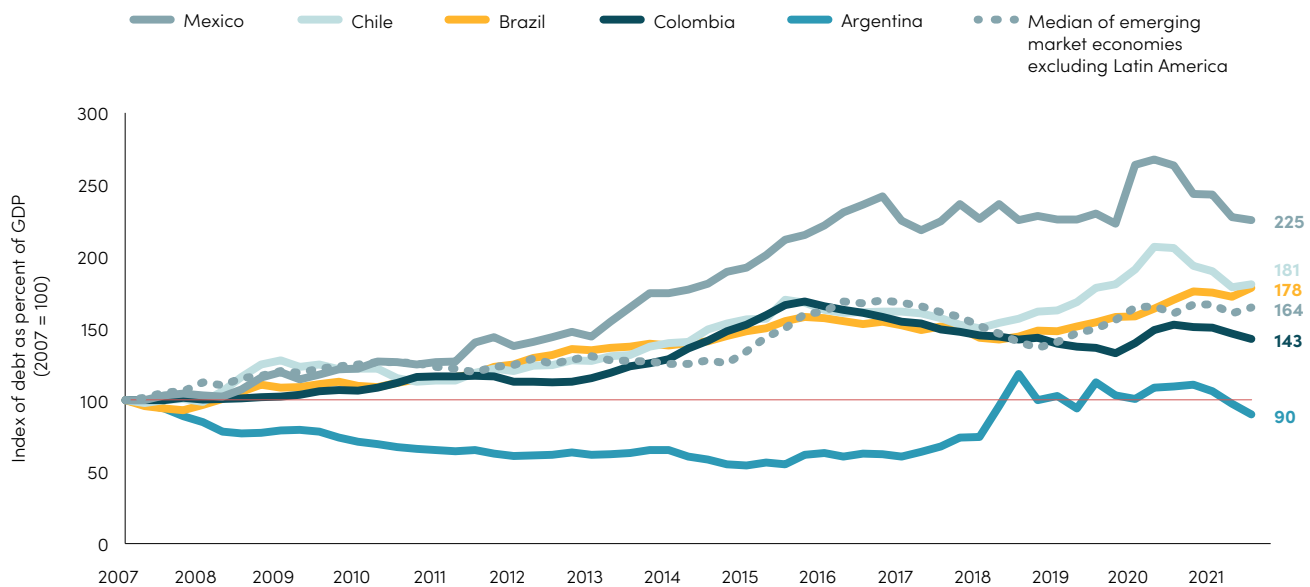
Firm Performance

How are firms in the region emerging from the pandemic? This section explores several dimensions of firm strength and vulnerability that can shed light on the future dynamics of the corporate sector in the region. The analysis suggests that firms depleted their productive capital stock and may need targeted and tailored assistance to support investment to consolidate the recovery.

DEBT AND LEVERAGE

Firm debt levels had risen before COVID-19 hit the region.¹⁸ Figure 6 plots an index of nonfinancial corporate debt (credit plus outstanding debt securities) as a percent of countries' GDP. This measure includes the domestic and external debt of firms. For most countries (an exception is Argentina), debt ratios grew strongly after the global financial crisis, surpassing

FIGURE 6 Index of nonfinancial corporate debt in selected countries in Latin America, 2007–21



Source: Bank for International Settlements (using [credit statistics](#) and [debt securities statistics](#)).

Note: Debt includes loans and securities outstanding. Emerging market economies included are China, Hungary, India, Indonesia, Malaysia, Poland, Russia, Saudi Arabia, South Africa, Thailand, and Turkey. Total nonfinancial corporate debt is defined as the sum of credit to nonfinancial sectors from all sectors and debt securities from both domestic and international markets. Total debt securities were used when available; when they were not available in the BIS database, domestic and international issuances were added to obtain the total, except in India and Saudi Arabia, which had data on international markets only.

¹⁸ Among six countries for which comparable data are available, the ratio of nonfinancial debt to GDP was 60 percentage points higher at the start of 2020 than at the outset of the global financial crisis on average.

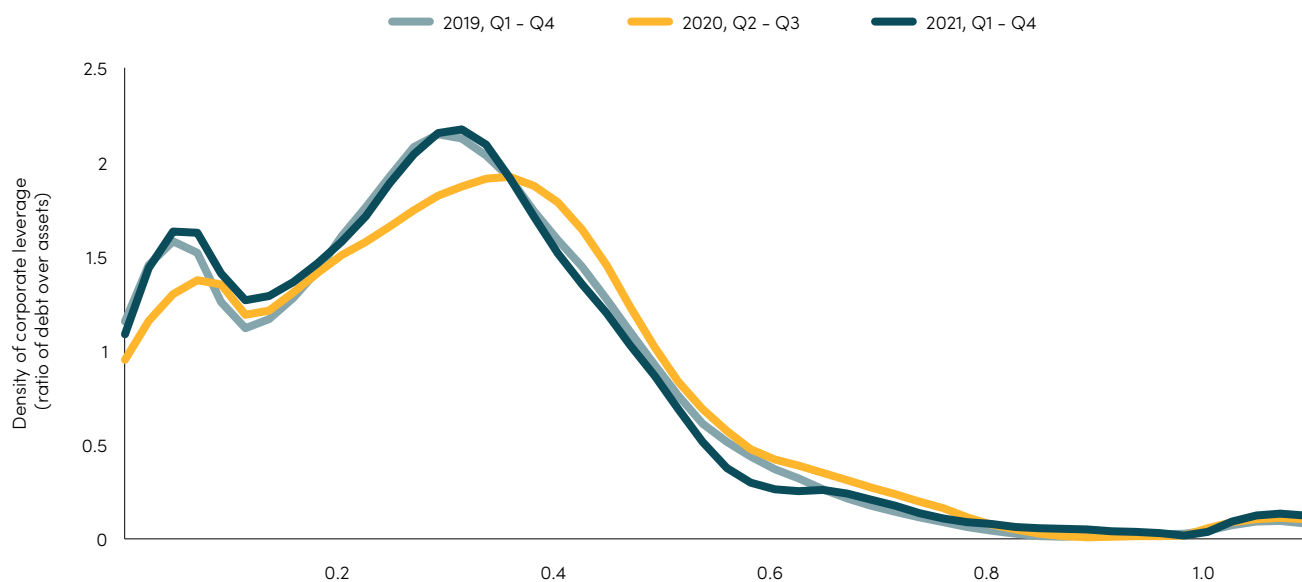
the ratio for the aggregate emerging markets group, excluding Latin America. Debt ratios stagnated around 2016, picked up again at the onset of the pandemic, and started to decline swiftly as economies started to recover.¹⁹

Among larger, listed firms, the crisis resulted in a rush for liquidity, with bond issuances by corporates reaching record levels through 2020, accompanied by new bank loans supported by government guarantee programs in many countries,²⁰ in a context of low global and domestic interest rates (Group of 30 2020). Figure 7 plots the distribution of corporate leverage before, during, and after the worst of the pandemic for LAC-5 countries (i.e., Brazil, Chile, Colombia, Mexico, and Peru). Leverage follows a pattern similar to that for aggregate debt of the nonfinancial private sector (plotted in figure 6), indicating that while leverage increased at the peak of the pandemic, once economic recovery started, it returned to pre-pandemic levels. In figure 7, the gray and

teal lines (representing the distributions of corporate leverage in 2019 and 2021) almost overlap toward the center of the distribution, where most firms are located. The yellow line, which represents leverage at the peak of the pandemic (second and third quarters of 2020) is mostly shifted to the right, suggesting higher levels of leverage at different points of the distribution (that is, for firms with median debt to asset ratios as well as for highly indebted companies).

The impacts of the pandemic varied across sectors, depending particularly on the difficulty of implementing social distancing given the typical activities of the sector. This heterogeneity is also reflected in the evolution of leverage. Figure 8 shows an index of corporate leverage by sector during the peak of the pandemic (second and third quarters of 2020) and after the peak (the four quarters of 2021). The index takes a value of 100 for the average value during 2019, the pre-COVID year. In many sectors, leverage increased during the peak of COVID and

FIGURE 7 Kernel density of corporate leverage among firms in selected countries, 2019–21



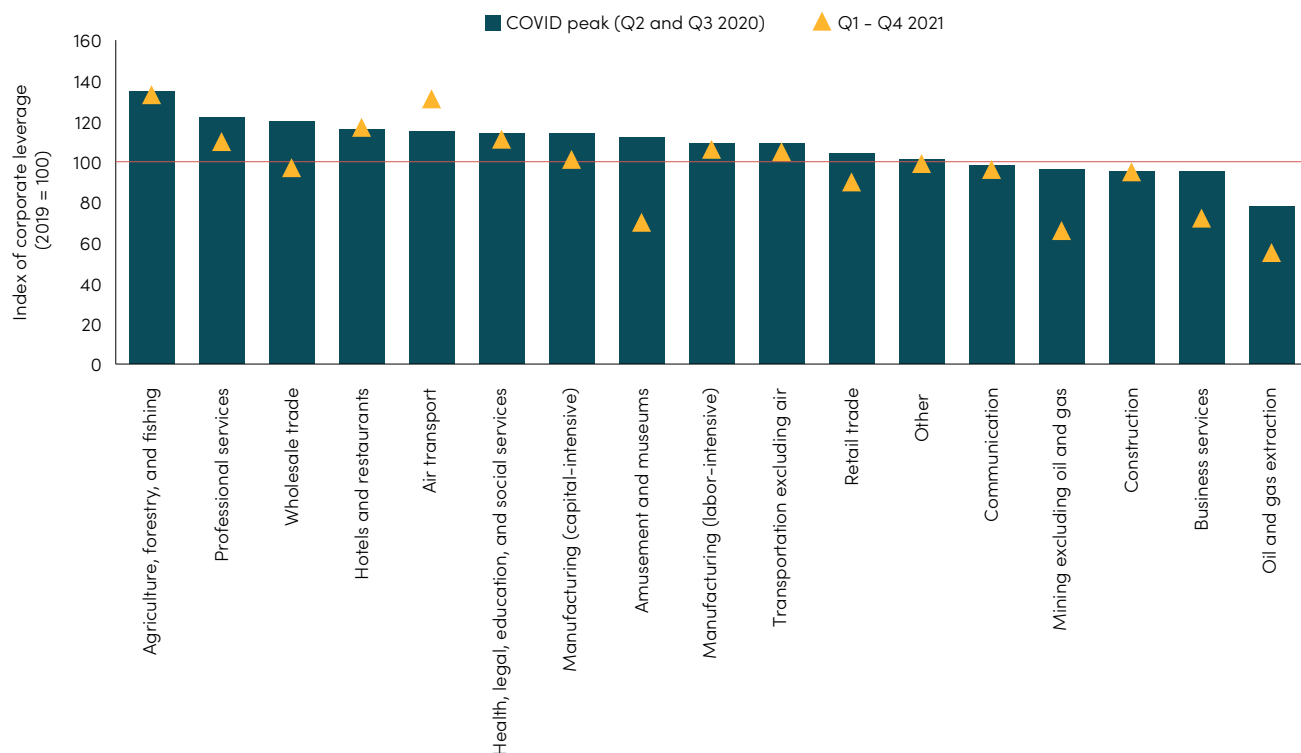
Source: Refinitiv.

Note: Figure illustrates the kernel density estimate of the corporate leverage distribution, defined as debt over assets, averaged over the quarters of each year shown for listed firms in Brazil, Chile, Colombia, Mexico, and Peru. All variables are winsorized at the top and bottom 1 percent.

19 The increase in debt ratios at the beginning of the pandemic was not caused solely by the sharp decline in GDP; data on dollar values of debt show a significant increase in indebtedness.

20 See Powell and Rojas-Suarez (2020) and Cavallo and Powell (2021) for descriptions of the support measures and their impacts on credit and for statistics on bond issuance. For a summary of policy measures, see the annex.

FIGURE 8 Index of corporate leverage in selected countries, by sector, 2020 and 2021



Source: Refinitiv.

Note: The index reflects the median of corporate leverage during the COVID peak period (average of the second and third quarters of 2020) and 2021 (average of four quarters). "Other" includes other services, excluding amusement and recreation, business services, hotels and restaurants, and public utilities. Figure includes data for listed firms in Brazil, Chile, Colombia, Mexico, and Peru.

then returned to pre-pandemic or even lower levels. Wholesale trade, capital-intensive manufacturing, amusement and museums, and retail trade are examples of sectors in this category. In other sectors—including agriculture, forestry, and fishing; professional services; hotels and restaurants; air transport and other transportation; health, legal, education, and social services; and labor-intensive manufacturing—debt increased and remained high or even continued increasing in 2021.

ANALYZING FIRM BALANCE SHEETS

Figure 9 shows the evolution of revenues in constant local currency for listed nonfinancial corporations in 16 sectors of the economy for Brazil, Chile, Colombia, Mexico, and Peru.

Each index takes the value of 100 in the fourth quarter of 2019 and tracks the evolution of median real revenues over the course of the pandemic. It reveals that some sectors have fully recovered, and others have not. It remains an open question whether all sectors will eventually recover, or some will be permanently scarred.

To glean further insights, firms are divided into two groups: firms in sectors in which the index of real revenues in Q4 2021 was at least 5 percent above the value in Q4 2019 (the "recovered" group) and firms in sectors in which the index of real revenues remained at least 5 percent below the Q4 2019 value (the "damaged" group). The recovered sectors include mining (excluding oil and gas); oil and gas extraction; agriculture, forestry, and fishing; and higher-capital-intensity manufacturing. The damaged sectors include professional services; business services; retail trade; transportation (excluding air

FIGURE 9 Firms' real revenues in selected countries, by sector, 2019–21



Source: Refinitiv.

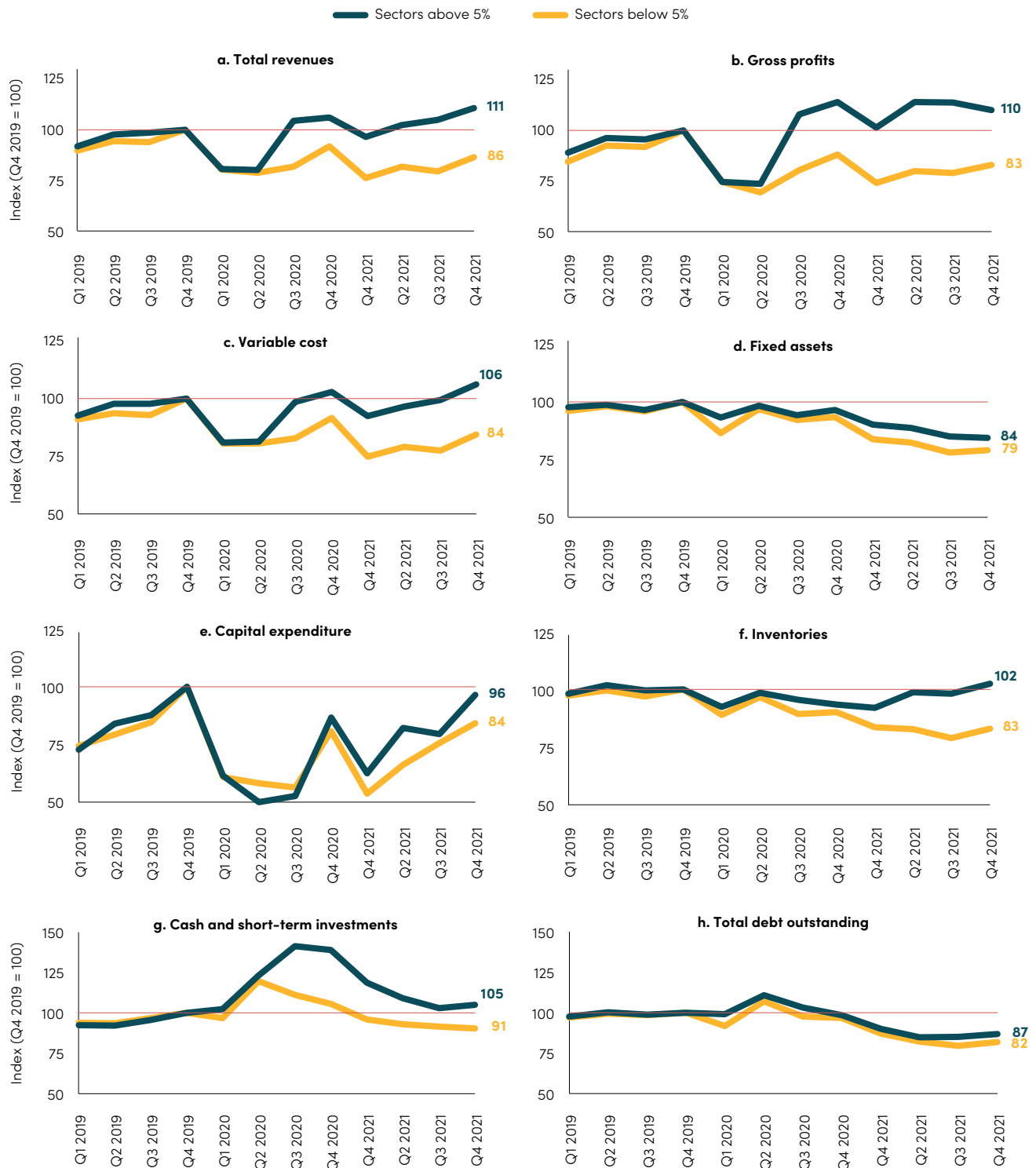
Note: Revenues of all firms in the database were transformed to local currency units and then deflated using the producer price index. An index was then calculated for each firm. Finally, the median value was calculated for each sector. Figure includes data for listed firms in Brazil, Chile, Colombia, Mexico, and Peru.

transport); air transport; health, legal, education, and social services; communications; construction; wholesale trade; hotels and restaurants; and amusement and museums; and other sectors. For each group, figure 10 presents key balance sheet indicators, all expressed as indices and in real terms, for the median firm in each group.

Panel a of figure 10 shows the evolution of real revenues. These patterns are similar to those in figure 9. At the beginning of the pandemic, revenues fell about 20 percent in real terms for firms in both groups, a figure similar to the decline during the global financial crisis of 2008/09.²¹

21 This number reflects the annual growth rate of quarterly firm revenues in local currency for publicly listed nonfinancial firms (Cavallo and Powell 2021).

FIGURE 10 Firm balance sheet indicators in “recovered” and “damaged” sectors in selected countries, 2019–21



Source: Refinitiv.

Note: “Sectors above 5 percent” are sectors in which revenues in Q4 2021 were 5 percent or more higher than their pre-pandemic (Q4 2019) levels in real terms. “Sectors below 5 percent” are sectors in which revenues were 5 percent or more lower than pre-pandemic levels. Variable costs (panel c) refer to those costs closely associated with revenues. Figure includes data for listed firms in Brazil, Chile, Colombia, Mexico, and Peru.

Panel b shows profits. As expected, firms with recovered revenues returned to profitability, whereas firms in the damaged group still had profits that were about 20 percent lower than they were before the pandemic.

Panel c plots the evolution of costs.²² During the pandemic, all firms reduced costs. Firms in the damaged group continued to maintain lower costs than before the pandemic. They have maintained persistently lower labor costs than before the pandemic, mirroring the impact on employment discussed below.

All firms saw fixed assets decline (panel d). Fixed assets of the median firm fell by about 20 percent in the damaged group and by 15 percent in the recovered group. Fixed assets are normally considered firms' productive assets, so this implies a significant decline in private sector productive capital.

All firms cut investment during the pandemic (panel e); only at the end of the sample period did capital expenditure start to recover. At the peak of the pandemic, investment in all firms had shrunk by more than 40 percent. At the end of 2021, even with a faster economic recovery than expected, the median firm in the damaged group still had levels of capital expenditure that were 15 percent below their initial value; recovered firms were about 3 percent below pre-pandemic levels. The combination of not investing, asset depreciation, and asset liquidation likely explains the contraction in fixed assets.

Panel f shows that firms depleted their inventories during the pandemic. For firms in the recovered group, the rate of depletion slowed by the end of 2020 and then those firms built inventories back up during the third quarter of 2021. In contrast, inventories continued to fall among firms in the damaged group, recovering slightly only beginning in the second half of 2021.

During most of the pandemic, firms in both groups held high levels of liquidity (panel g), most likely as insurance against a potentially longer pandemic or a return of lockdowns. At the end of 2020, liquidity fell back close to pre-pandemic levels.

Debt rose as the crisis deepened but peaked in 2020, declining thereafter (panel h). Firms in the recovered group may have used their liquidity holdings, in addition to their profits, to bring down debt. Leverage ratios, even for firms in the damaged group, returned to pre-pandemic levels. Firms may have paid off debts or may have sought reductions through negotiations with creditors.

The pandemic has left significant scarring in larger, listed firms. Investment in the region fell, rebounding only recently, mostly in recovered sectors. In both the recovered and damaged sectors, a significant amount of cumulative investment was sacrificed, as reflected in the fall in fixed assets. As fixed assets are normally considered productive assets, this decline will restrict output going forward. At the same time, costs fell and have not recovered, likely reflecting lower labor costs. Debt rose during the pandemic; instead of financing investment, proceeds from increased indebtedness were used largely to finance higher cash reserves, given the exceptional demand for liquidity. Those cash reserves have since been depleted, likely to pay down debt, which has now fallen back to below pre-pandemic levels.

How will firms finance investment going forward and bring the capital stock at least back to pre-pandemic levels? Unless revenues continue to rise well above pre-pandemic levels, the only mechanisms for rebuilding capital stock are issuing more debt or attracting more direct investment in the form of equity. But stock market valuations have fallen; volatility has risen, leading to a shorter distance to default (Heresi and Powell forthcoming); and global interest rates have started to climb, making it unlikely that firms will be in a strong position to raise the financing required to boost fixed assets to pre-pandemic levels. Failing a robust policy response, it may take considerable time to replace the capital stock lost as a result of the crisis, something that is likely to limit economic growth going forward.

22 This measure of costs are those costs associated with the revenues of firms and so is an estimate of firms' variable costs.

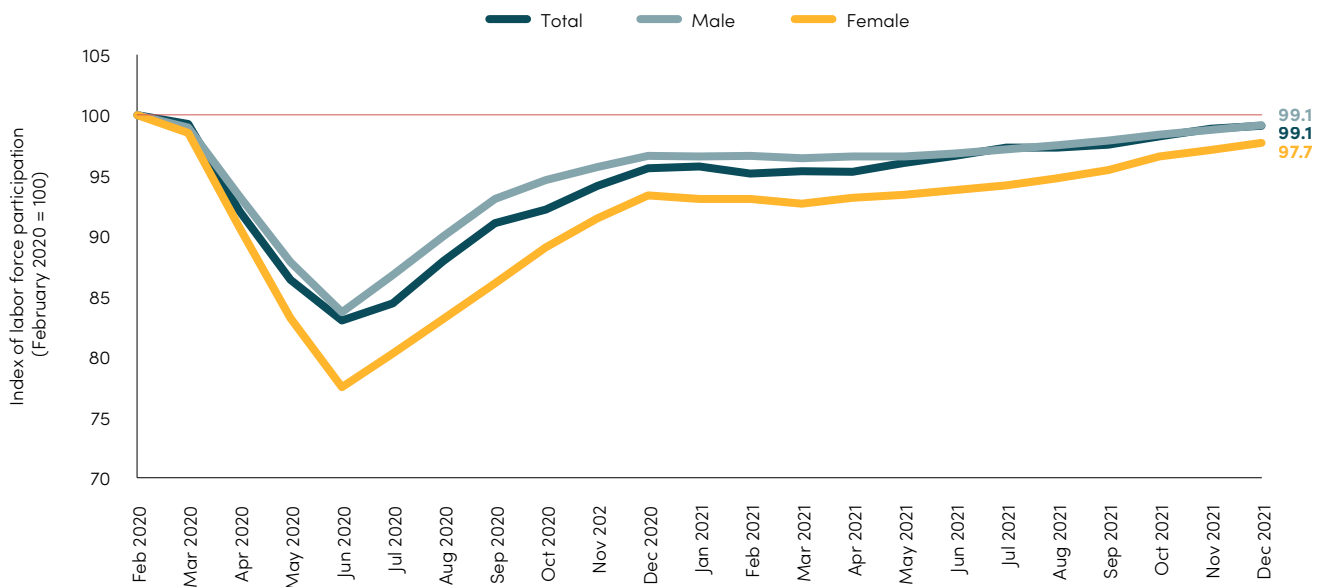
Labor Market Performance

Labor markets were strongly impacted by the COVID-19 crisis. Participation rates fell sharply, and for some countries and for women they remain below pre-crisis levels. Employment has since recovered but not as strongly as output. Unlike previous crises, more jobs were lost in the informal sector compared to the formal one, but informality has come back very strongly. This section provides an overview of labor market performance through the pandemic and in the recovery phase, noting the variation across types of firms, sectors, and countries.

PARTICIPATION RATES AND EMPLOYMENT

In the median country in the region, the labor participation rate fell 17 percent at the peak of the pandemic (figure 11). Since then, it has recovered, returning to close to pre-pandemic levels. But median rates hide variation across countries and by gender (figure 12). Female labor market participation is about 2 percent lower than before the pandemic. In Chile that figure is 9 percent and in Colombia it is 7 percent. The corresponding decreases for male labor market participation are 6 percent and 3 percent in Chile and Colombia, respectively. Female

FIGURE 11 Female and male labor participation rates in Latin America, 2020–21



Sources: ILO (2022a) and national sources.

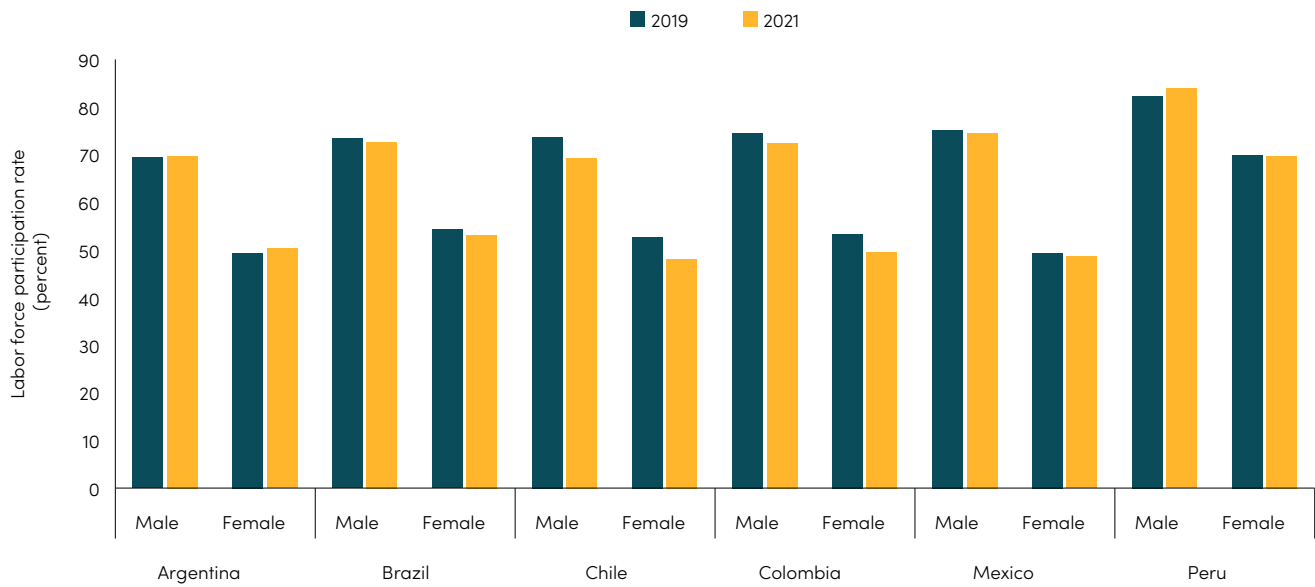
Note: Median values are reported. The sample includes Argentina, Brazil, Chile, Colombia, Mexico, Peru, and Uruguay.

employment has still not returned to pre-COVID-19 trends, in part because women are discouraged from reentering the workforce (Cavallo et al. 2022).

During the economic rebound, employment recovered less than output (figure 13). Although GDP and employment levels

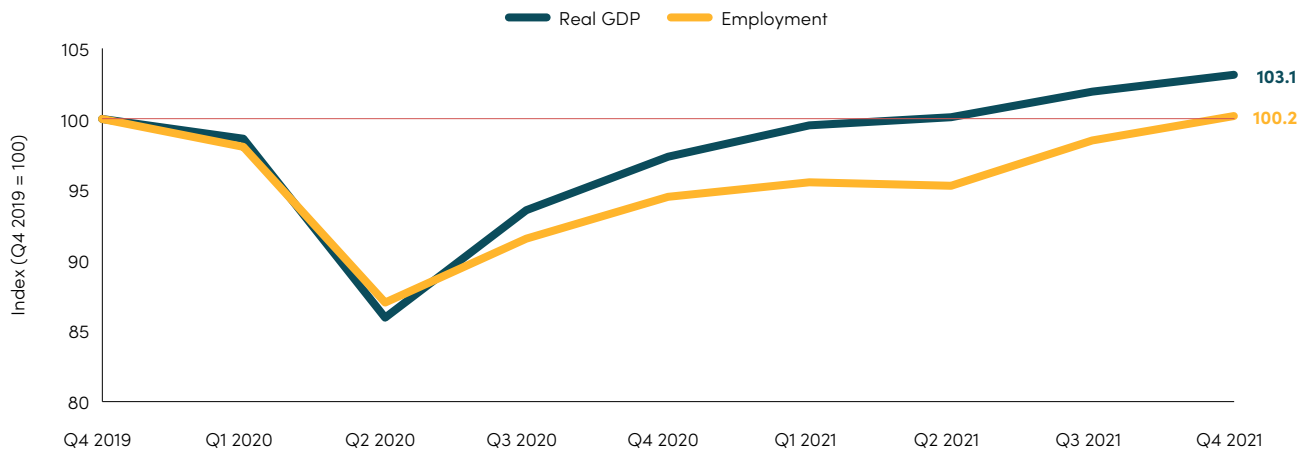
in most countries have returned to their pre-crisis levels, employment recovery in some segments remain sluggish. It remains to be seen whether this mismatch in the speed of recovery is permanent or transitory.

FIGURE 12 Female and male labor participation rates in six countries in Latin America, 2019 and 2022



Sources: ILO (2022a) and national sources.
Note: Figures are from December.

FIGURE 13 Output and employment in Latin America and the Caribbean, 2019–21



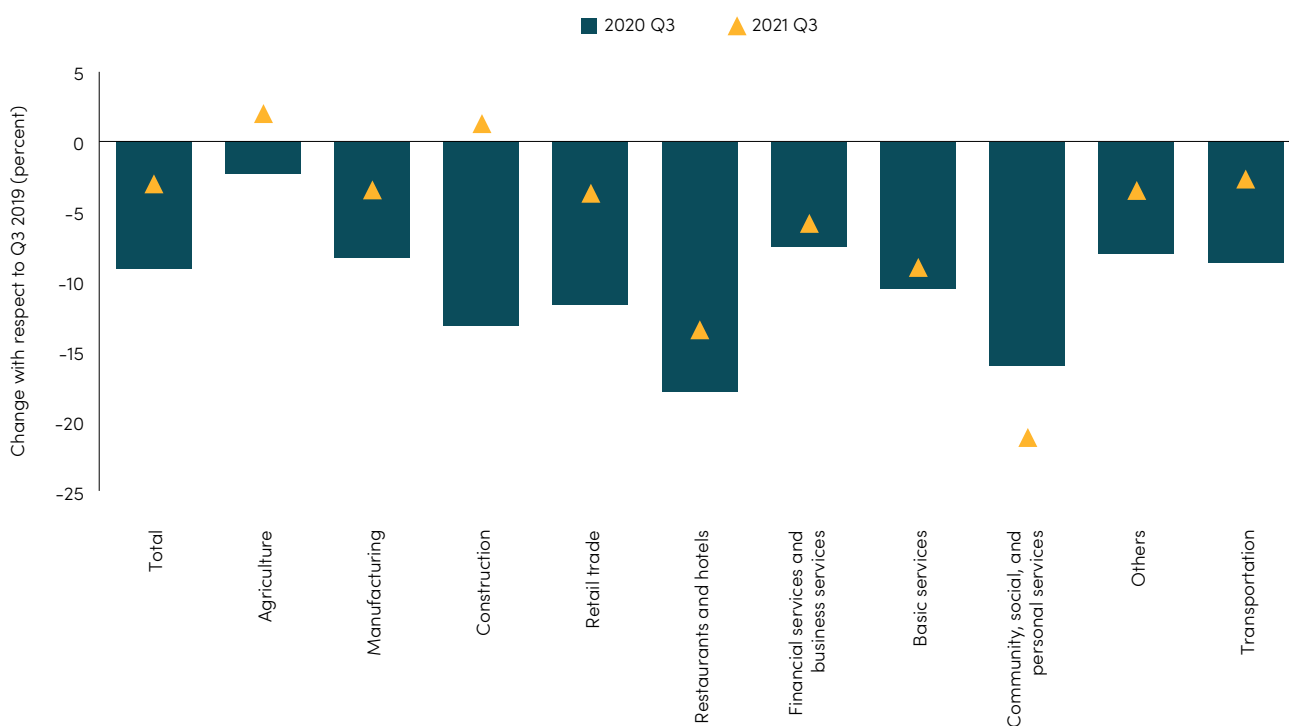
Sources: National sources.
Note: Median values are reported. Sample includes Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Dominican Republic, Mexico, Nicaragua, Paraguay, Peru, and Uruguay.

DIFFERENCES ACROSS COUNTRIES AND SECTORS

There are significant differences in the behavior of labor markets across sectors and countries (figures 14 and 15). Some key sectors, such as some manufacturing, that were in positive terrain in the revenue classification (see figure 9) appear to be experiencing a jobless rebound. In many economies (including Barbados, Chile, Colombia, Costa Rica, Dominican Republic, Jamaica, Nicaragua, and Peru), total employment

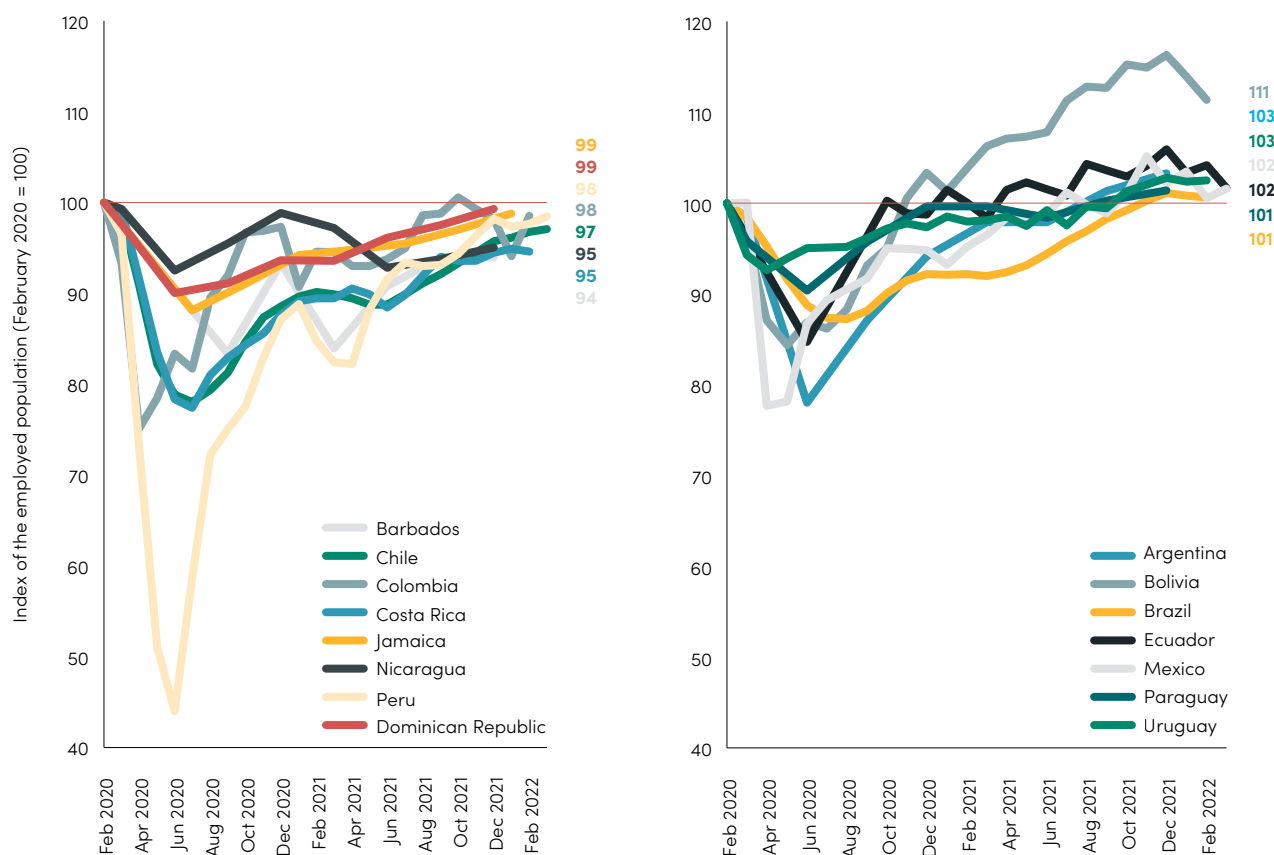
has not yet recovered to pre-pandemic levels (figure 15). Still, the experience of large economies (such as Argentina, Brazil, and Mexico) as well as Bolivia, Ecuador, Paraguay, and Uruguay suggests that employment may return to pre-pandemic levels over time. Even if employment returns to pre-pandemic levels, however, it still remains below its pre-pandemic trend (Cavallo et al. 2022), indicating that the effect of COVID-19 on job losses is expected to last some time. There were also disproportionate job losses and declines in working hours among smaller firms relative to larger firms (ILO 2022a).

FIGURE 14 Changes in employment across sectors in Latin America and the Caribbean, 2020 and 2021



Source: ILO (2022a).

FIGURE 15 Share of population employed in selected countries, 2020–22



Source: *Observatorio Laboral*, IDB (building on national household surveys).

INFORMALITY AND SKILLS

Although the decline in informal employment was larger than the decline in formal employment (unlike in previous crises), informality rebounded very strongly and now exceeds pre-pandemic levels in many countries. Higher levels of informal employment suggest that productivity may be even lower post-pandemic than it was before the crisis.

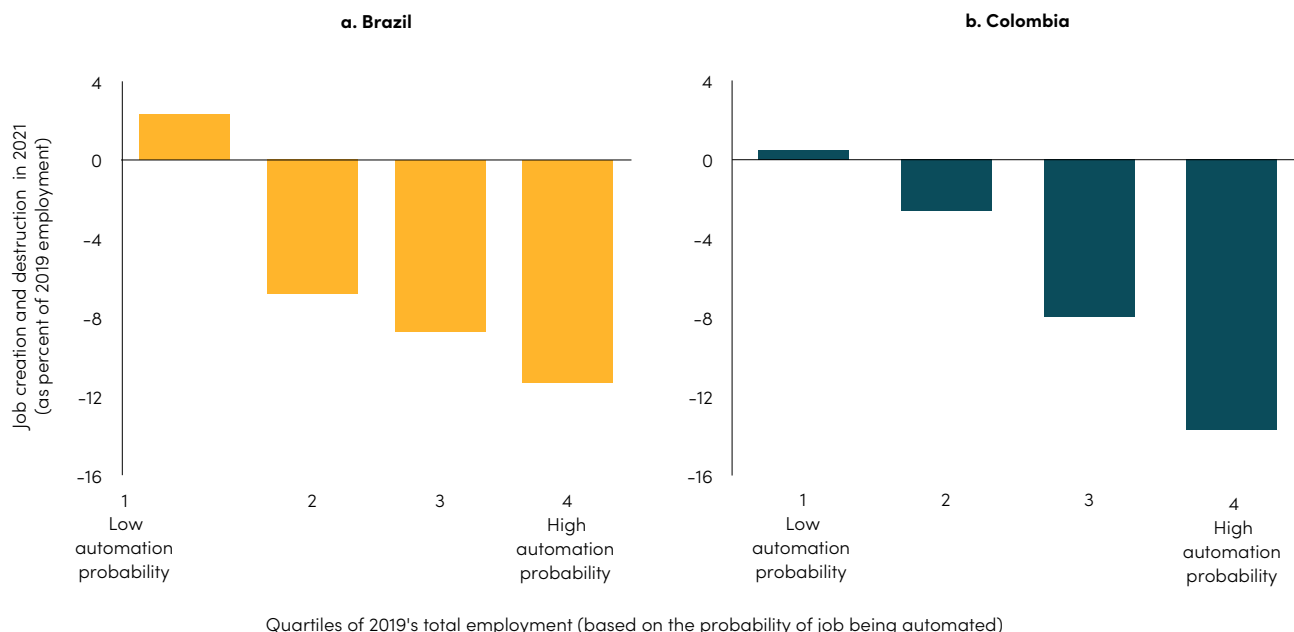
There is some evidence that the recovery of employment has varied depending on the skills required to perform a job, as well as whether an activity can be automatized. A forthcoming study by Benitez and Parrado shows that during the crisis, the

decline in employment in Brazil and Colombia was steepest in activities with a higher probability of being automatized (figure 16). These jobs are usually low-skilled. The share of such jobs in total employment had been falling before the pandemic; the pandemic accelerated the trend.

During Q2 2021, self-employment rose by almost 25 percent while wage employment (employees of firms) rose by just 9 percent.²³ Informal employment accounted for over 70 percent of net job creation since mid-2020 in Argentina, Mexico, Paraguay, and Peru and for over half of job growth in Brazil, Chile, and Costa Rica (figure 17).

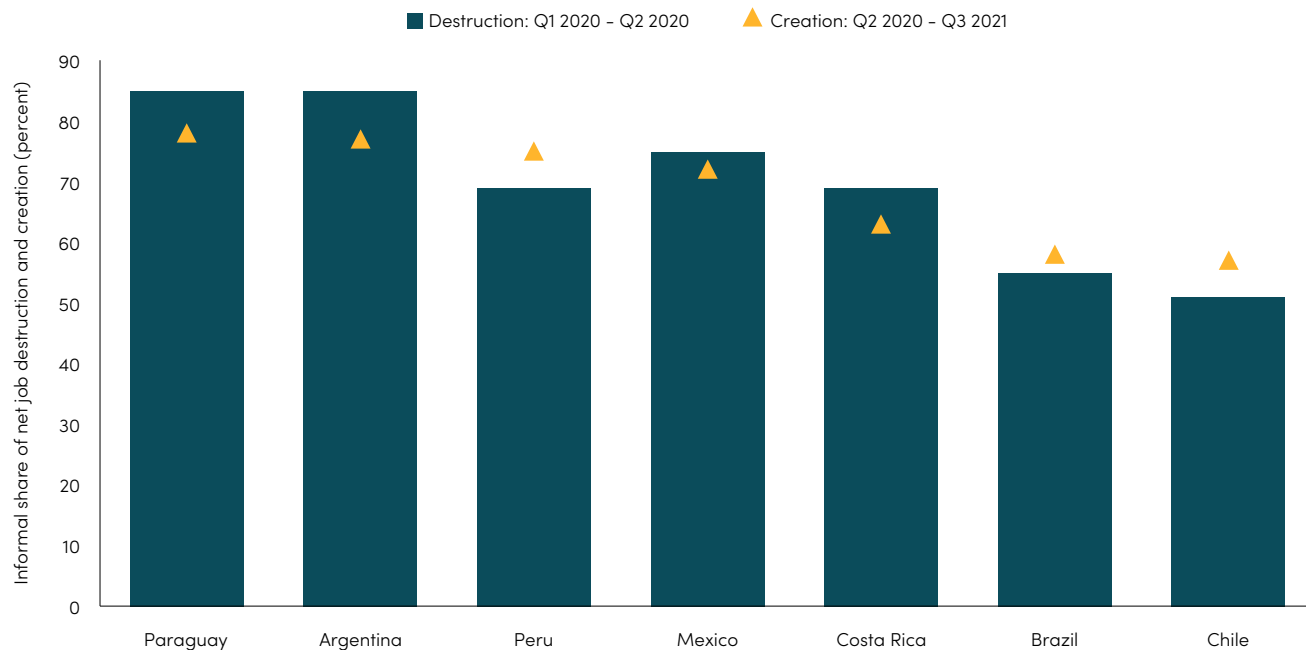
23 This figure is based on employment statistics in 11 countries in the region.

FIGURE 16 Job creation and destruction in Brazil and Colombia, by probability of automation, 2021



Source: Benitez and Parrado forthcoming.

FIGURE 17 Share of informal employment in net job destruction and net job creation in selected countries



Source: ILO (2022b) based on ILO-STAT Short-Term Labour Force Statistics.

Note: For Argentina and Peru, job creation covers Q2 2020–Q1 2021. Data for Argentina are for urban areas only.

Recommendations: Policies to Support Firms and Workers

The next two subsections describe a set of challenges and opportunities for firms and labor markets in the region. A third subsection then provides recommendations related to each challenge.

CHALLENGES AND OPPORTUNITIES FOR SUPPORTING FIRMS

Most of the public sector financial support to firms in the region has been aimed at delaying or reducing debt payments or facilitating additional debt to be taken via public guarantees. Although effective at allowing firms to weather the most severe periods of the pandemic, this kind of public intervention is ill suited to promote the additional investment needed to recover pre-COVID fixed asset levels or invest in the new technologies needed to adapt to digitalization. Public intervention is justified by the greater risk-sharing capacity of the state and the fact that firms are in a weaker position not because of poor governance and excessive risk taking but because of a massive exogenous shock. The challenge is to design instruments that combine this higher risk-sharing capacity in the public sector with the private sector know-how needed to screen viable firms while avoiding political capture.

Alternative Support Mechanisms for Firms

Subsidizing debt or providing guarantees on debt helped firms to survive the crisis. Support in the form of equity (or equity-like instruments, such as subordinated debt) may be more appropriate in the recovery phase. Such support should allow

firms to reduce their debt-to-capital ratios. Countries should seek to set up institutions with robust governance structures that rely on private screening and crowd in private resources. Given tight fiscal positions in the region, multilateral institutions such as the IDB and the World Bank could play a key role in funding these programs and provide guidance on appropriate governance. Their private sector arms (IDB Invest and the International Finance Corporation [IFC], respectively) could play a co-financing role. Clear exit strategies should be designed to free public resources after the COVID recovery has consolidated. These exit strategies should be country specific and tailored to the private funding options available in each economy, including specialized funds for private equity or public placements.

Digitalization and New Technologies

Virtually every activity within a firm, from production to sales and marketing, is changing as a result of digitalization and the introduction of new technologies. Evidence for developed economies indicates that digitalization increases productivity growth at the firm and industry level (OECD 2019). However, spillovers and misinformation about potential returns to investments can reduce the private returns of investing in such technologies. Moreover, firms left with high debts after the pandemic may not be in a position to make the necessary investments. A comprehensive public intervention may therefore be needed.

New Firms and Venture Capital

New and dynamic firms that are successful enough to become medium-size or even large firms are often considered drivers

of economic growth. The region appears to not produce such enterprises—or at least not enough of them. The COVID crisis has had a mixed impact, benefitting many firms in technology sectors and firms with good work-at-home arrangements but harming firms in other sectors. Although technology firms have performed well, according to IDB Lab calculations, \$9.4 billion a year in new venture capital investment is needed in the region to match the investment of Organisation for Economic Co-operation and Development (OECD) countries (Peña 2021). Three factors explain this gap: (i) the almost total lack of innovation in smaller countries; (ii) the conservative nature of lenders (who prefer established technologies); and (iii) significant barriers to entry, especially for entrepreneurs from underrepresented or lower-income backgrounds.

Firm Closures, Bankruptcy, and Reorganization

Judicial rules regarding firm reorganization and bankruptcy may be affecting investment and the capital structure of firms. If bankruptcy rules are not clear and there is little confidence that the rules will be applied in a consistent fashion, firms will be very risk averse, favoring high levels of capital and liquidity, and investment will be low.

Credit markets remain relatively shallow. Larger firms appear to have debt ratios that are in line with firms in other countries at the same income level, but SMEs in the region continue to report access to credit as a serious constraint. If bankruptcy procedures are inefficient and perceived as unpredictable and unfair, economic theory suggests that intangible investment, such as innovation, research, and development—all areas thought to be critical for growth—will suffer.

The current rules may also affect the composition of corporate financing. If rules are excessively debtor-friendly, outside credit is likely to be very expensive, and creditors may restrict lending or extend loans only on the basis of collateral that can be seized if the loan goes bad.

Current bankruptcy rules further affect extra-judicial processes. There have been remarkably few formal firm

insolvencies or formal judicial debt restructurings. Instead, firms have sought extra-judicial routes, perhaps because of the long delays and inefficiencies in formal processes. Creditors that have little trust in the predictability of the formal processes will wish to avoid them, but their avoidance may influence the outcomes of the extra-judicial route.

Inefficiencies in formal processes may also exacerbate coordination problems and raise tensions among stakeholders, rather than being conducive to finding a resolution that maximizes the restructured value of the firm. The relevant stakeholders may then resort to more expensive foreign processes (such as Chapter 11 in the United States) to restructure firm balance sheets.

International Firms and Multilatinas

A further set of issues relates to international companies with assets in several countries in the region, often known as *multilatinas*. A frequent practice for insolvency processes that involve multijurisdictional insolvencies is for the company to enter bankruptcy procedures in the United States, the United Kingdom, or other jurisdictions with global financial centers. Firms do so partly because many countries do not have systems in place that recognize the complexities of holding assets and liabilities in different countries.

The increased integration of companies across the region requires mechanisms to allow a company that has operations in multiple jurisdictions to exit bankruptcy efficiently. These mechanisms should enable the company to operate its critical assets in those multiple locations during the process. However, competition between insolvency regimes, and ring-fencing of assets, may create challenges and inefficiencies.

Balancing Crisis Responses with Investment Considerations

Foreign investment has long been a critical component of economic development in the region, frequently through investments related to long-term state contracts or concessions. The pandemic had diverse impacts on foreign investment,

provoking a set of legal disputes.²⁴ It is important to balance the impact of crises with established contractual and legal frameworks, in order to provide certainty and stability to investors and investment projects (IDB 2021a). Numerous bilateral and multilateral investment protection treaties involving countries in the region provide protections related to fair and equitable treatment, discriminatory conduct, expropriation, and contractual violations, among others, as well as access to well-established international dispute mechanisms such as arbitration before the International Centre for Settlement of Investment Disputes (ICSID) at the World Bank. Governments will wish to maximize positive solutions and minimize treaty breaches that might give rise to costly disputes. Responses to challenging scenarios need to be tailored to address near-term concerns while balancing the benefits of a stable environment for highly desirable long-term investment.

CHALLENGES AND OPPORTUNITIES FOR IMPROVING LABOR MARKETS

The pandemic appears to have accelerated working from home, digitalization, and automation trends. It is also likely to have caused permanent shifts in the demand for workers across sectors (as a result of reallocation) and for workers with different skills (as a result of digitalization and new technologies). Reallocation may be efficient given changes in demand, preferences, technology, and relative prices—but it also likely implies the displacement of workers and potentially higher unemployment during a transition. Various policies can help address the challenge.

Short-Cycle Programs to Focus on Skills

As firms begin to hire, many workers will wish to acquire new skills. Upskilling and reskilling the population will be critical, not just for economic recovery and transformation but also

for equity and inclusion. Short-cycle programs (SCPs), a type of higher education program, are particularly well suited to address these challenges. They graduate students at higher rates than bachelor's programs and obtain better labor market outcomes (employment, formal employment, and salary) than high school graduates and, remarkably, college dropouts (Ferreyra et al. 2021). These results are particularly noteworthy given that, on average, SCPs take more disadvantaged, less traditional students than bachelor's programs. Still the design of such programs can be improved.

Skills for the Digital Transformation

There is a strong complementary between the adoption of digital and new technologies and skills in general. Skill shortages reduce the productivity benefits of investing in digital technologies. SMEs tend to have more difficulty than larger firms attracting the talent required to support the digital transformation (Kergroach 2021).

Four types of skills are typically needed:

- ▶ specialist skills for ICT professionals
- ▶ generic ICT skills for other workers
- ▶ complementary skills, such as general cognitive and interpersonal skills
- ▶ managerial and organizational skills.

Training in these areas could be enhanced.

Labor Regulations to Reduce Informality and Boost Productivity

The region requires better-functioning labor markets to achieve high growth and employment in the post-COVID era. Existing labor legislation in most of the region handicaps labor mobility, unduly restricts the range of allowable labor contract modalities, and encourages informality. It does so through high firing costs and by prohibiting or limiting the scope for labor contracts that deviate from the standard (9 to 5) type, including part-time, flexible-hours, hourly, seasonal,

²⁴ See, for example, Group ADP and Vinci Airports v. Republic of Chile (ICSID Case No. ARB/21/40); Concesionaria Peruana de Vías—COVINCA, S.A. v. Republic of Peru (ICSID Case No. ARB/21/45); Desarrollo Vial de los Andes S.A.C.—DEVIANDES v. Republic of Peru (ICSID Case No. ARB/20/18); Sociedad Portuaria Regional de Buenaventura v. Agencia Nacional de Infraestructura Colombiana (ANI) (Bogotá Chamber of Commerce); Construcciones y Contratas (FCC) v. Caja de Seguro Social (CSS) (International Chamber of Commerce). <https://icsid.worldbank.org/cases/recent>.

and fixed-term contracts. The current regulatory framework—which aims to protect job stability at the expense of formal job creation and the efficient allocation of labor resources—constitutes a major drag on the post-COVID recovery.

Labor market reform is politically difficult, not least because of the strong, well-organized resistance of incumbents (workers with formal jobs) and with the lack of voice and organization of potential beneficiaries (unemployed and informal workers). It is also socially difficult because it needs to strike a balance between equity and efficiency.

RECOMMENDATIONS

This section sets out recommendations that address the challenges and opportunities for firms and labor markets described above.

Create New Programs to Support Firms

Countries should consider the creation of a new public-private institution with a limited time mandate and a professional staff hired largely from the private sector to help support firms with good prospects. The institution—which could take various forms, such as a fiduciary fund—would evaluate and develop techniques for identifying viable firms with good business models that suffered during the pandemic and that may not be in a position to invest to rebuild the capital stock lost during the crisis. The institution would have its own resources to invest, through a variety of instruments, and could coordinate with other institutions, as detailed below.

The success of this proposal will depend critically on the governance of the institution. It is imperative to avoid political influence in lending decisions, which has plagued some financial institutions in the region in the past. IDB Invest and/or the IFC should advise on the institutional design and organizational structure and provide resources as appropriate. Multilateral institutions, such as IDB, the World Bank, or the Development Bank of Latin America (CAF), could contribute to the initial funding of the institution, in order to catalyze

additional private sector funding by banks or through domestic capital markets. Making the institution regional might enhance its political independence.

In some countries, public banks and other public financial institutions are already significant sources of finance for firms. The proposed new institution should complement existing institutions, improving their performance by identifying firms with good prospects and coordinating financing for them.

The institution could acquire a minority stake of equity in a promising firm and be involved in the company's board, where it would help to strengthen corporate governance. It could also play a catalytic role in obtaining a matching debt-to-equity conversion from existing creditors. The new institution could be a domestic version of multilaterals such as the IFC or IDB Invest. The capital injections could lead to an initial public offering on the country's stock exchange, widening the capital base of the firm and providing funds for the public-private institution to exit. In some cases, capital injections could be used to facilitate consolidation in affected sectors.

Although the institution would require financing, the objective would be for it to be profitable, so that any loan for initial financing could be repaid and fiscal costs would be zero. It would be critical to hire a high-quality team and ensure that the institution worked professionally and independently from political influence.

Promote Digitalization and the Adoption of Technology

To prevent Latin America and the Caribbean from falling farther behind with respect to the adoption of digital technologies and new technology, countries should consider a multiprong approach to fast-track digitalization that includes the following actions:

1. Formulate an explicit digitalization strategy to promote the adoption of digital technologies by firms and foster smart infrastructure.²⁵ The strategy could include a

²⁵ See [Cavallo, Powell, and Serebrisky \(2020\)](#) for a discussion of the switch to digital infrastructure.

robust system to establish and maintain digital identities, help provide cybersecurity, and ensure that there is appropriate legislation protecting data.

2. Prioritize investments in infrastructure to support digitalization by firms and individuals, which has been shown to be cost-effective and enhance growth. Increasing access to high-speed internet through better digital infrastructure would promote digitalization. Doing so would require greater public investment or the facilitation of private investment through an appropriate regulatory and business framework.
3. Develop or expand “innovation and digitalization funds” that firms can apply to support digitalization and new technology adoption.
4. Provide incentives for firms to digitalize, such as accelerated tax depreciation for investments in digital and other advanced technologies that help firms make the transition to the digital economy.²⁶
5. Consider other vertical policies, such as using funds to support digitalization in critical sectors, where the bang for the buck may be large. Funds could also be deployed to support digitalization in certain types of firms, such as small firms that may have more difficulty with the initial investments and that present promising business plans and demonstrate potential for expansion. Firms where the adoption of digital technologies is complementary to the demand for more labor rather than a substitute may also be suitable targets for support.
6. Create a task force aimed at promoting digitalization and technology adoption, to ensure consistency. One alternative would be a one-stop shop that would advise firms on the spectrum of policies.²⁷

Boost the Entry of High-Quality Firms with High Growth Potential

Countries should develop programs to improve access to venture capital through international networks or the

development of a local market.²⁸ They should identify firms with growth potential and help them for a limited period; they should avoid supporting firms simply because they are small or for an extended period. Programs should help firms develop business ideas and translate them into realistic and profitable business plans.

Countries should promote the creation of incubators that allow these new firms to grow in their early days. Incubators have followed various models and enjoyed mixed success. Countries should try various designs, evaluate them, learn from their experiences, and refine design parameters based on lessons learned. Such incubators could be supported by local authorities but under a national program that then incorporates the different design ideas and conducts evaluations.

Multilateral financial institutions can support venture capital funds; their participation may help attract private investments from outside the region or within the country, fostering a network of potential investors. Multilateral institutions can also help design the governance of such funds and either evaluate them themselves or support evaluations conducted by third parties.

Reform Firm Reorganization and Bankruptcy Procedures

Countries should consider reforms to improve formal insolvency codes, following five broad principles:

1. **Flexibility.** Around the world, and especially in common law jurisdictions such as the United States, judges are granted flexibility in overseeing insolvency proceedings. The most effective insolvency systems allow for some flexibility to help resolve and/or address the myriad claims that arise. Countries in the region should explore ways they can provide judges involved in insolvency proceedings with some degree of flexibility. Of course, this flexibility may come at a cost: In a region already grappling with concerns over corruption and transparency

26 In 2017, the Italian government set up a fiscal incentive of this nature; for every €100 it invested, firms saved €36 over the lifetime of the investment. SMEs were the main beneficiaries, but the increase in digitalization and employment was most pronounced for firms with more than 250 employees (Bratfa et al. 2021).

27 A report by the OECD (2019) claims that exploiting the complementarities could provide an additional benefit of as much as 20 percent.

28 The role of the Multilateral Investment Fund (MIF) in improving the venture capital ecosystem in Brazil is a noteworthy case.

of the judicial system, greater flexibility may undermine confidence in the process itself. To mitigate these concerns, policymakers should put monitoring and review systems in place based on international practices.

2. **Transparency.** Insolvency frameworks need to be transparent, a feature that many frameworks in the region lack. Transparency becomes even more important when there is greater flexibility. Every judicial decision should be based on evidence, and documentation should be made public so that third parties can analyze decisions and assess the consistency and predictability of their rulings. These third parties could then analyze the way in which the processes are working.
3. **Debtor-in-possession (DIP) financing.** A feature that has been adopted in some jurisdictions but is not yet very common is DIP financing. Under this mechanism, companies can obtain financing while in financial distress and going through a formal restructuring or bankruptcy procedure, allowing them to exit in a stronger position.
4. **Human capital expertise.** The levels of experience and expertise of courts handling insolvency in the region vary significantly across and within countries. Inexperience and lack of expertise can lead to uncertain results, which disincentivize the use of formal insolvency proceedings. To encourage greater predictability of formal insolvency proceedings, it is important to ensure that judges overseeing such proceedings have the requisite experience and expertise. One way of doing so is to establish specialized insolvency courts. Such courts would enable judges to focus on a specialized area of law and allow for the development of more visible and specialized precedents. Greater predictability in the process would encourage greater use of the formal insolvency process.
5. **Procedural adaptations and efficiency.** Cross-border insolvency considerations are beyond the scope of this report, but insolvency courts facing the disruption of a crisis such as the pandemic should consider prudent procedural adaptations that improve efficiency to confront evolving circumstances while protecting the efficacy of insolvency processes.

Create a New Insolvency Forum

There is a need for an international forum to provide technical expertise on insolvency issues to countries and to ensure consistency across countries. Specialized insolvency courts are expensive, and many smaller countries may lack the required resources. Moreover, cross-border issues are becoming increasingly common, complicating insolvency procedures greatly. National rules should aim for consistency with other countries' processes, which requires coordination as these rules are being designed. Some flexibility is critical, as excessively rule-based systems across countries may create conflicts, ring-fencing, and inefficiencies.

There are a number of existing procedures for insolvency cases that include cross-border features, or where the use of national processes may not be considered appropriate, such as presenting those cases in the United States or another jurisdiction. But there are also drawbacks as this is normally expensive, and judges may not be aware of regional nuances. There are also a set of existing arbitration processes, but none appears attuned to dealing with the issues that have sprung up as a consequence of the COVID-19 crisis.

The working group recommends the creation of a new insolvency forum, to be supported by multilateral institutions and appropriate international legal bodies. This new institution would focus on assisting small countries with limited human capital on complex situations in which international (extra-regional) firms may have assets and/or liabilities in many jurisdictions and on multinationals. The institution could also play a role in relation to concessions if these are not already covered by existing processes. The idea is not to compete with existing institutions and processes but to add value. The institution could provide precedents and thought leadership for application across the region.

Strengthening Investment Protection

Countries should use or develop mechanisms to facilitate substantive and transparent consultations on issues that have significant economic and investment impacts. Existing investment protection systems provide mechanisms to facilitate consultations between countries and investors to advance

common goals and avoid disputes. Well before the pandemic, several countries in the region established governmental entities or committees involving one or more ministries to advise on ways to facilitate relations with foreign investors, avoid disputes and navigate consultation processes with investors, and manage disputes. All countries should establish mechanisms along these lines and use them according to international norms.²⁹

Address the Shortcomings of Short-Cycle Programs for Technical Training³⁰

Short-cycle programs for technical training can play a particularly useful role in the current context. The following recommendations address potential shortcomings in current programs:

1. Design an information system that makes program-level information available for policymakers who regulate and oversee these programs and for students, to help them make informed choices.
2. Increase funding for SCPs, including through subsidies, as students in these programs are more disadvantaged than those in traditional bachelor's programs.
3. Strengthen the oversight and regulation of SCPs, focusing on outcomes rather than inputs.
4. Create flexible pathways between SCPs and bachelor's degrees, so that students enrolled in an SCP can transition to a traditional university program (and vice versa).

Implement Policies to Boost Skills for the Digital Age

One of the constraints to rapid digitalization is inadequate skills in the region. To address this key barrier, countries should:

1. Subsidize training, through vouchers and tax incentives.

2. Develop expertise in identifying companies in which an improvement in skills would bring significant benefits and provide them with information on relevant programs.
3. Promote within-industry collaboration and collaboration between industries and the public sector to identify skill gaps and develop programs to improve the skillsets of current and future employees.

Adopt More General Labor Market Reforms

The full spectrum of labor market reforms is outside the scope of this report, but several reforms that encourage formality and facilitate greater labor mobility are worth noting:

1. Reduce labor taxes and other charges on formal jobs that finance benefits, and finance those benefits through general taxation.³¹
2. Allow a wider range of labor contracting modalities, without unduly shifting downside risks to the worker. Doing so entails adequate and fully portable pension, disability, and health benefits and a well-designed savings- or insurance-based scheme to sustain workers' standard of living during unemployment spells or transitions between jobs. Rather than protect jobs, social benefits should protect workers' mobility.
3. Phase out specific subsidies, policies, and programs that were adopted to compensate labor income for vulnerable populations during the pandemic, and ensure the design of more general social transfers are consistent with labor market participation.
4. Enhance policies to support female employment, such as boosting the provision of preschool education and care for seniors and the ill.
5. Draw on the expertise of multilateral financial institutions for advice on these labor market interventions.³²

29 See, for example, the recommendations in IDB (2021a).

30 See Ferreyra et al. (2021) for further discussion regarding strengthening SCPs.

31 See chapter 5 of the United Nations Development Programme's *Regional Human Development Report 2021* and Cavallo et al. (2022).

32 Misión de Empleo in Colombia is a useful example.

Annex. Business Support Programs in Brazil, Chile, and Colombia

BRAZIL

Brazil's support to the corporate sector comprised a suite of policy measures, including the expansion of credit to SMEs; loan restructuring, which benefited 30 percent of Brazil's banking system portfolio (Central Bank of Brazil 2021); and guarantees.

The main programs included the following:

- ▶ Pronampe (Programa Nacional de Apoio às Microempresas e Empresas de Pequeno Porte, the National Support Program for Micro Enterprises and Small Companies), which was intended to provide already accredited branches of financial institutions guarantees on loans for micro and small firms in the program, if they made a commitment to preserve the number of employees from the date of contracting the loan up to 60 days after receiving the last installment
- ▶ The Emergency Program Credit Access (PEAC)
- ▶ Circular 4,033, of June 24, 2020, which established deductions from the enforceability of the balance of credit operations for financing of working capital via

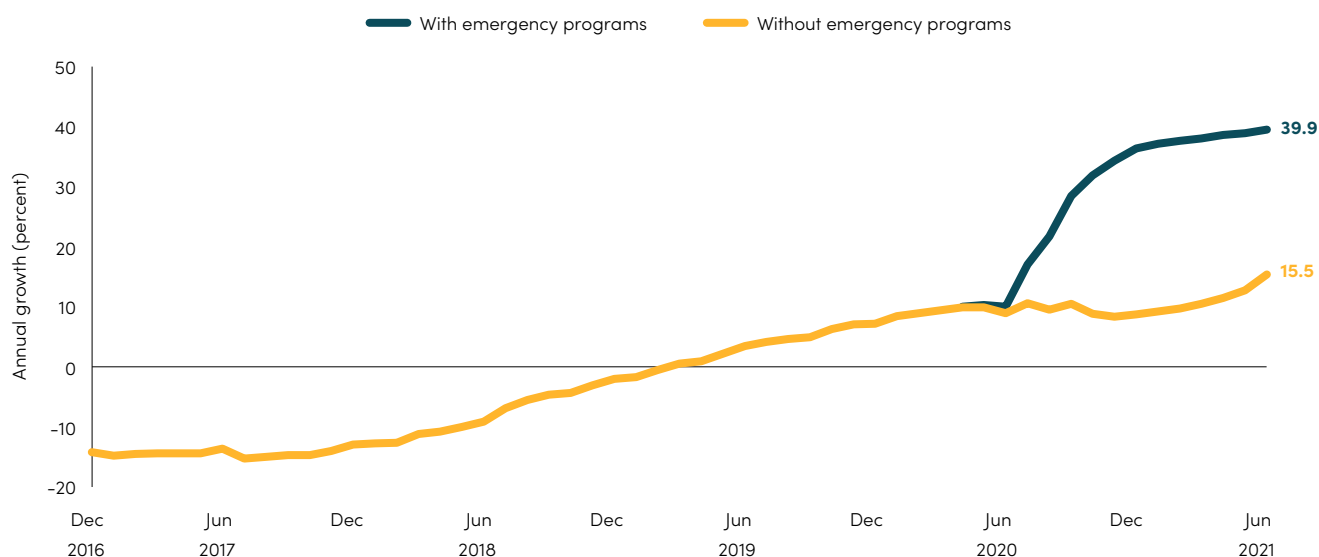
reserve requirements on savings deposits

- ▶ The Emergency Jobs Support Program (Programa Emergencial de Suporte a Empregos, [PESE])
- ▶ The Working Capital Program for Business Preservation (Programa de Capital de Giro para Preservação de Empresas, [CGPE]).

According to Brazil's central bank, emergency programs increased credit to MSMEs (figure A.1). The risks of these loans remained low, with acceptable levels of nonperforming loans as of 2021.

Three features from the Brazilian programs are worth highlighting. First, credit risk seemed to be a more pressing constraint to credit supply expansion than liquidity, at least at the onset of the pandemic. Therefore, the softening of reserve requirements by the central bank evolved to acknowledge the importance of credit risk. Second, individuals shifted their deposits from smaller financial institutions to larger ones. Third, some temporary programs became permanent, with potentially significant fiscal implications.

FIGURE A.1 Credit to small and medium-size enterprises, annual growth in Brazil, 2018–21



Source: Central Bank of Brazil.

CHILE

Corporate support in Chile was multifaceted and evolved as the dynamics of the pandemic unfolded. Public guarantee and employment support programs reached about 6 percent of 2020 GDP (Huneeus et al. 2021). Eighty percent of the stimulus came from credit guarantees under the public credit guarantee program (the Guarantee Fund for Small Entrepreneurs, Fondo de Garantía para Pequeños Empresarios, [FOGAPE COVID-19]).³³ FOGAPE COVID-19 built on an existing initiative, expanding the total amount allocated to the program to 4.6 percent of Chile’s GDP, with some modification in its terms. Since guarantees were only partial and the lower interest rate increased the lending applicant pool, more screening was performed. Banks had to roll over previously issued debt under the program, which proved effective to provide additional liquidity for firms. As in other countries, large corporations drew down their credit lines.³⁴

In the second phase, the program expanded coverage, focused on incentivizing long-term investment, and targeted SMEs. A third phase became even more selective, targeting SMEs in the sectors hit hardest by the pandemic. Figure A.2 shows how FOGAPE fostered credit growth.

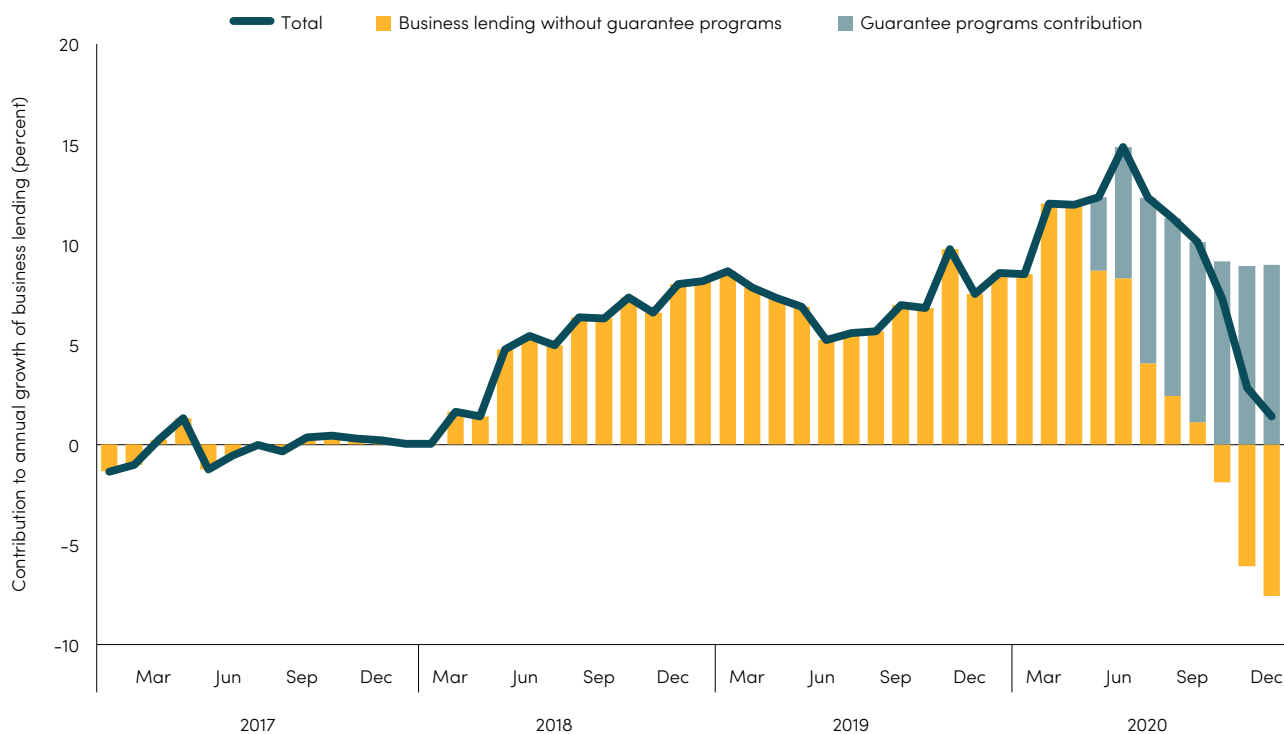
Another important source of financing to the private sector came from the central bank’s implementation of flexible liquidity facilities, which were issued sequentially as the pandemic unfolded. The later stages aimed to supplement the FOGAPE programs.

The credit facility (Conditional Credit Facility Subject to Increase Lending, *Facilidad de Crédito Condicional al Incremento de las Colocaciones* [FCIC]) was implemented in three stages, consisting of financial lines conditioned to the granting of credits (particularly to smaller firms) and a liquidity credit line, for a total of \$40 billion (about 6 percent of 2020 GDP) in the first two phases. The purpose of these measures was to

³³ FOGAPE is a state fund that guarantees a percentage of the capital of loans, leasing operations, and other mechanisms. In 2020, medium-size companies were permanently incorporated; large companies that did not have guarantees or whose guarantees were insufficient could access the program temporarily.

³⁴ For example, firms in the United States drew down their credit lines during the COVID-19 shutdown as a precautionary move to mitigate future liquidity risk until the economy started to stabilize (Bosshardt and Kakhbod 2021).

FIGURE A.2 Contribution of guarantee programs to annual growth of business lending in Chile, 2017–20



Source: Astorga et al. 2021.

support the commercial credit channel, especially to smaller companies (firms with less than \$330,000 in annual revenue), which received about \$22 billion. FCIC II, implemented in July 2020, focused on the FOGAPE-COVID program and on non-bank financial institutions. In March 2021, FCIC III provided another \$10 billion of support, complementing the FOGAPE recovery program.

A final set of measures consisted of regulation aimed at restructuring commercial loans whose debtors were in arrears. The program was originally set to expire in July 2020 but was extended for six months, accompanying the FOGAPE program.

The programs implemented during the COVID crisis were effective in maintaining the dynamism of commercial loans. According to an analysis by the Financial Markets Commission (CMF), the share of credit allocated to MSMEs increased by 20 percentage points due to these programs in 2020.

An evaluation of these crisis credit programs (particularly the FOGAPE program) also found that banks curtailed non-tail risk by being more sensitive to risk from large firms, that the program deductible covered initial losses, and that the effective guarantee increased with the default rate (Huneus et al. 2021). It is still too early to understand the repayment performance of firms that benefited from the FOGAPE programs.

COLOMBIA

Colombia provided support through two mechanisms: (a) direct support to employment, by subsidizing the cost to formal employment for a period of time (through the Support to Formal Employment Plan, Plan de Apoyo al Empleo Formal [PAEF]) and (b) a guarantee scheme (Unidos por Colombia, United for Colombia).

PAEF was designed as a subsidy to the payroll of formal workers at registered firms that could certify a significant drop in

sales during the pandemic. The program took some time to be implemented, during which formal employment decreased. Initial hurdles included a complicated system of control agencies (Contraloría and Procuraduría) in a mechanism that dealt directly with corporates. As of June 2022, PAEF was still active for some segments and current regulations have been extended until December 2022,³⁵ and some similar measures (subsidizing payroll taxes to incentivize youth employment) were operating through the Ley de Inversión Social.

The largest volume of resources allocated to credit support was delivered through credit guarantees (Unidos por Colombia) provided by the Fondo Nacional de Garantías (FNG), which dealt with second-tier institutions and discount rates.³⁶ With modifications to accommodate the scheme, the program used pipelines that were already in place. An advantage of the mechanism was that it allowed banks to work with a counterpart that they knew well, using familiar procedures. Between April 2020 and the first week of May 2022, the FNG provided guarantees for approximately \$9.8 billion (\$6.1 billion as part of the Unidos por Colombia Program). Of those, around 40 percent went to micro enterprises, 28 percent to small ones, 29 percent to median ones and only around 3 percent to large companies.³⁷ The credit line for large companies was not massively used and was probably not needed; credit lines devoted to guarantee bond issuances were not successful.

Guarantee caps were allocated for financial intermediaries. Each institution was in charge of gathering detailed debtor

information. This arrangement may have delayed implementation, and, while creditor information was available across government, some banks do not always wish to rely on such aggregate information sources. Most of the lines created guaranteed 80–90 percent of the credit amount, with no initial distinction by company size. According to financial institutions participating in the program, guarantee levels provided enough incentives to expand credit supply to firms. Within this program, financial institutions could claim the guarantee once they had taken all the necessary actions to recover the resources and obtained a court order. In the view of financial institutions, the need for a court order reduced their incentives to work toward recovering the resources, as the process was not related to their effort and could be delayed.

Increasing the guarantee for smaller firms also proved useful. A second adjustment allowed loans to be refinanced or “reloaded,” especially for microenterprises.³⁸ Before the change, fresh resources could not be used to cover pre-existing debt. Microentrepreneurs, many of them owners or managers of previously informal businesses, could recover part of the fees they paid within the program if they provided certain proofs of formalization.

Regarding insolvency procedures, in 2020, Colombia issued Decreto Ley 560, to expedite resolution mechanisms for companies; although it was supposed to be in place until April 2022, it was extended in November 2021 through December 2022.

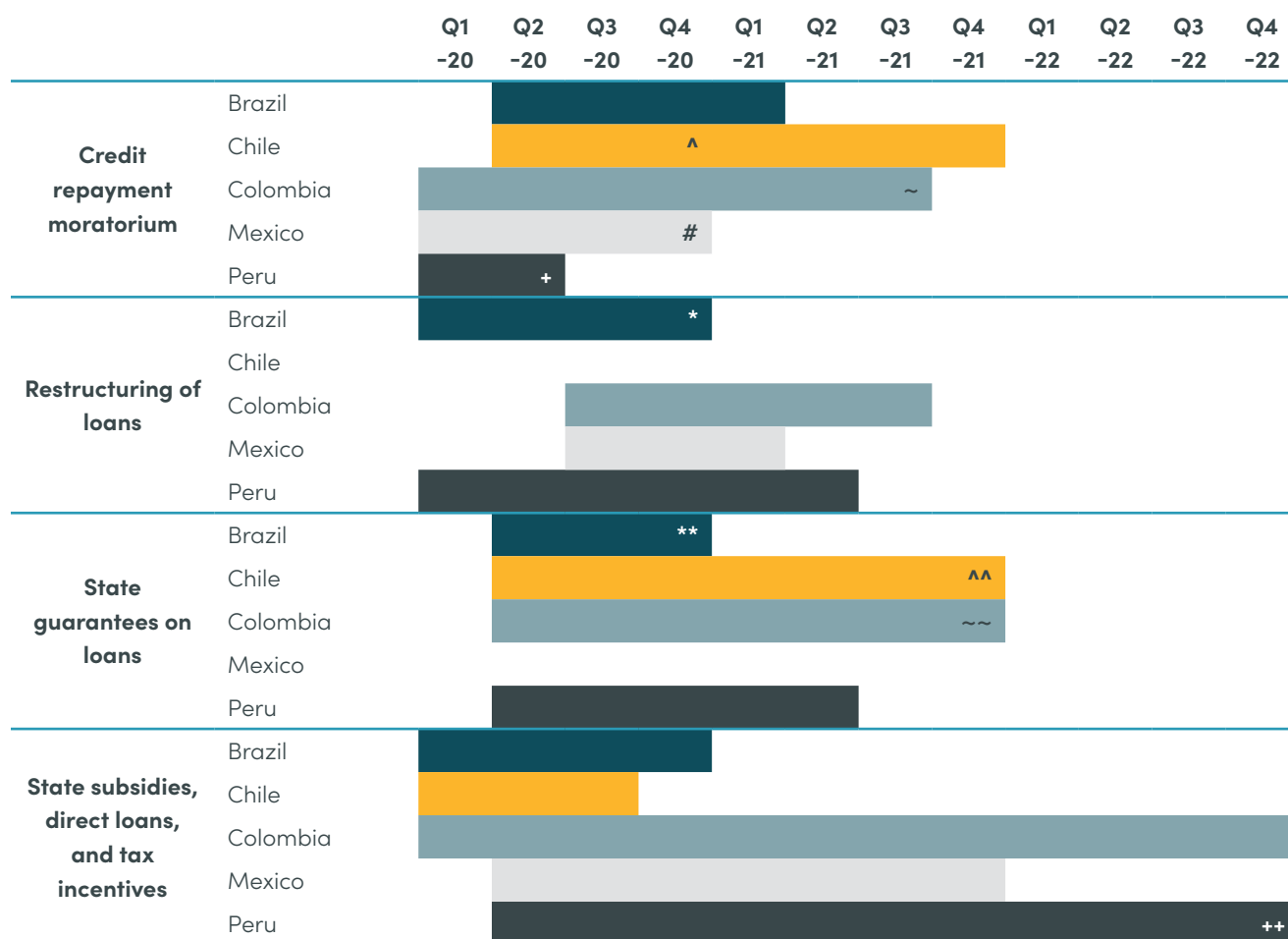
35 See <https://knowledge.leglobal.org/corona/country/colombia/colombia-paef-extends-the-benefits-of-subsidies-for-dependent-workers/>.

36 Second-tier institutions lend resources to financial intermediaries (first tier), which eventually lend the resources to firms. In this setting, second-tier banks not only expand credit supply by making more resources available but may also provide resources at low costs and with flexible conditions that the intermediaries may then pass on to the final recipients of loans.

37 See <https://www.fng.gov.co/transparencia/reporte-de-informacion/garantias-por-colombia>.

38 For example, an entrepreneur could decide to take out a new loan to pay off an existing loan.

TABLE A.1 Policy measures supporting firms initial and termination dates in selected countries, 2020–22



Sources: World Bank (Feyen et al. 2022), IDB (Bolzico and Prats, 2022a and 2022b), and national sources.

Notes: (1) This table displays the temporal coverage of government programs related to support for firms in select countries, from February 2020 to June 2022. This information is displayed to the best of our knowledge as of the publishing date of this report, but there could be unintended omissions (for instance, measures at the subnational level that have not been captured by the sources used or by the national institutions we have relied on to obtain primary information).

(2) Categories shown correspond to Feyen et al.'s (2022) level-3 types of policy measures. In turn, these policies are subcategories of measures classified as "support to borrowers" within "banking sector." This source includes other finance-related policies, but for the purpose of this report, we focus on this subset, which are the most relevant policies for firms in terms of direct support. Note that certain level-3 policy measures are excluded, namely, "caps on interest rates or fees" (which only appeared in Brazil and Colombia) and "flexibility in credit information requirements" (which only appeared in Brazil). These two policies, according to the World Bank, were only operational between the second and the fourth quarter of 2020.

(3) Some features about moratoria programs are worth noting: (a) they were voluntary in Brazil, Chile, Colombia, and Peru; (b) in most cases, repayment deadlines had to be extended, and (c) uptake was similar across countries. 32 percent of total commercial loans were subject to moratoria in Brazil; 37 percent in Chile; 38 percent in Colombia; and 41 percent in Peru (Bolzico and Prats 2022b).

(4) When countries implemented several policies of the same type, we show the earliest implementation date within the set of policies and the latest termination date—i.e., if a country established guarantee program A in 2020 Q1 and this program ended in 2020 Q2, and guarantee program B started in 2020 Q2 and terminated in 2020 Q4, the "state guarantees on loans" row would indicate that programs were active between 2020 Q1 and 2020 Q4.

(5) Regarding guarantee programs, note that many countries capitalized existing guarantee funds and other programs to help with the impacts of the pandemic on firms. These recapitalizations are not displayed in the table but are taken into account to show the temporal coverage for beneficiary firms. Guarantee programs were heterogeneous in sizes across the region: in Brazil they represent 0.7 percent of GDP, 6.3 in Chile, 2.5 in Colombia, and 8.3 percent in Peru (Bolzico and Prats 2022a).

(6) Termination dates represent the point when firms can no longer apply for programs or when certain measures no longer apply to firms—note that disbursements may continue beyond termination dates for countries such as Brazil and Colombia (see additional notes below).

Additional notes regarding specific policies by country:

Brazil: *Firms could apply for 12 months extensions until December 2020 (so, the restructuring could last until December 2021). **At the time of the publication of this report, there were [ongoing discussions](#) about reopening one of the emergency facilities (PEAC). The Pronampe program (which supports small and medium firms) [remains active](#), though not focused on providing COVID-specific support and disbursements [continued in 2021](#).

Chile: ^Moratorium [continued](#) after 2020 Q4, but only for FOGAPE (the public guarantees fund) credit. ^^Some of the changes to SMEs lending conditions adopted during the pandemic [remain](#) for new loans.

Colombia: ~Firms could [apply](#) for a 6-month extension until March 2021 in the “Colombia Responde” program; Bancoldex offered grace periods from 6 months to 3 years until August 2021. Accordingly, moratoria [may continue](#) until 2024 for some loans. ~~Firms could apply to the program “Unidos por Colombia” until December 2021, but disbursements [are still taking place](#) in 2022.

Mexico: #The CNBV allowed the deferral of the payment of interest or capital for 4 or 6 months for some credits, and for 18 months for agricultural or rural sector loans. Accordingly, while firms could only apply until 2020 Q4, deferrals [may have lasted](#) until 2022 Q2.

Peru: +While this measure ended in June 2020, loan tenors could be extended for 12 months, so firms [may have benefitted](#) from this until May 2021. The guarantee program “Reactiva Perú” [allowed](#) to reschedule loans up to December 2022. ++Government subsidized firms’ payroll during different months during 2020, 2021 and 2022. The last program of payroll subsidies [is planned](#) for September-2022 and will last for 6 months.

References

- Araujo, Juliana, José Garrido, Emanuel Kopp, Richard Varghesse, and Weijia Yao. 2022. "Policy Options for Supporting and Restructuring Firms Hit by the COVID-19 Crisis." Strategy, Policy and Review Department and Legal Department, February, International Monetary Fund, Washington, DC. <https://www.imf.org/en/Publications/Departmental-Papers-Policy-Papers/Issues/2022/02/18/Policy-Options-for-Supporting-and-Restructuring-Firms-Hit-by-the-COVID-19-Crisis-464871>.
- Astorga, G., G. Covarrubias, M. Núñez, M. Urbina and M. Vera, and CMF (Financial Markets Commission). 2021. "Programas de fomento del crédito comercio en tiempos de COVID." Documento de trabajo No 03/21. Chile: Comisión para el Mercado Financiero. https://www.cmfchile.cl/portal/estadisticas/617/articles-49457_doc_pdf.pdf.
- Benitez, Miguel, and Eric Parrado. Forthcoming. *Jobless Recovery in Latin America: The Role of Automation in Times of COVID-19*. Washington D.C.: Inter-American Development Bank.
- Bolzico, J. and J. Prats 2022a. "Esquemas de garantía pública para créditos bancarios en tiempos de COVID-19 en América Latina y el Caribe." Washington D.C.: Inter-American Development Bank. <https://publications.iadb.org/es/esquemas-de-garantia-publica-para-creditos-bancarios-en-tiempos-de-covid-19-en-america-latina-y-el>.
- Bolzico, J. and J. Prats 2022b. "Programas de moratoria de créditos bancarios en tiempos de COVID-19 en América Latina y el Caribe." Washington D.C.: Inter-American Development Bank. <https://publications.iadb.org/es/programas-de-moratoria-de-creditos-bancarios-en-tiempos-de-covid-19-en-america-latina-y-el-caribe>.
- Bosshardt, J., and A. Kakhbod. 2021. "Why Did Firms Draw Down Their Credit Lines During the COVID-19 Shutdown?" *COVID Economics* 78 (May). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3696981.
- Bratta, B., Santomartino, V., and Acciari, P. (2021). "Assessing profit shifting using Country-by-Country Reports: a non-linear response to tax rate differentials." Dipartimento delle Finanze WP, (11). Roma: Dipartimento delle Finanze. <https://ideas.repec.org/p/ahg/wpaper/wp2021-11.html>.
- Cavallo, E., A. Galindo, V. Nuguer, and A. Powell, coordinators 2022. *From Recovery to Renaissance: Transforming Crisis into Opportunity*, 2022 Latin American Macroeconomic Report, Inter-American Development Bank, Washington, DC. <https://flagships.iadb.org/en/MacroReport2022/From-Recovery-to-Renaissance-Turning-Crisis-into-Opportunity>.
- Cavallo, Eduardo A., and Andrew Powell, eds. 2021. *Opportunities for Stronger and Sustainable Postpandemic Growth*. 2021 Latin American and Caribbean Macroeconomic Report. Washington, DC: Inter-American Development Bank. <https://flagships.iadb.org/en/MacroReport2021/Opportunities-for-Stronger-and-Sustainable-Postpandemic-Growth>.
- Cavallo, Eduardo A., Andrew Powell, and Tomás Serebrisky, eds. 2020. *From Structures to Services: The Path to Better Infrastructure in Latin America and the Caribbean*. Development in the Americas Series. Washington, DC: Inter-American Development Bank. <https://flagships.iadb.org/en/DIA2020/from-structures-to-services>.
- Central Bank of Brazil. 2021. *Relatório de Estabilidade Financeira* Volume 20 | N. 2 | Outubro 2021. Brasília, Federal District. <https://www.bcb.gov.br/en/publications/financialstabilityreport>.
- COFIDE (Corporación Financiera de Desarrollo). 2022. "Presentación Corporativa al primer trimestre 2022." Lima: Corporación Financiera de Desarrollo. <https://www.cofide.com.pe/COFIDE/uploads/medios/Presentacion-Corporativa-Mar-2022.pdf>.
- Confecámaras. 2021. *Informe Dinámica de Creación de Empresas en Colombia*, enero - diciembre de 2021. Bogotá. <https://confecamaras.org.co/analisis-economico>.
- ECLAC (Economic Commission for Latin America and the Caribbean). 2020. *Sectors and Businesses Facing COVID-19: Emergency and Reactivation*. Special Report COVID-19 No. 4. Santiago: United Nations. <https://doi.org/10.18356/9789210054683>.
- Ferreira, Maria Marta, Lelys Dinarte Díaz, Sergio Urzúa, and Marina Bassi. 2021. *The Fast Track to New Skills: Short-Cycle Higher Education Programs in Latin America and the Caribbean*. Washington, DC: World Bank. <https://openknowledge.worldbank.org/handle/10986/35598>.
- Feyen, E.H.B., T. Alonso Gispert, T. Kliatskova, D. S. Mare. 2020. *Taking Stock of the Financial Sector Policy Response to COVID-19 around the World*. <https://datacatalog.worldbank.org/search/dataset/0037999>.
- Group of 30. 2020. *Reviving and Restructuring the Corporate Sector Post-COVID: Designing Public Policy Interventions*. https://group30.org/images/uploads/publications/G30_Reviving_and_Restructuring_the_Corporate_Sector_Post_Covid.pdf.
- Heresi and Powell (forthcoming) "Corporate Debt and Investment in the post-Covid World" IDB Working Paper, Washington DC.
- Huneus, F.J., M. Kaboski, S. Larrain, S. Schumkler, and M. Vera. 2022. "The Distribution of Crisis Credit: Effects on Firm Indebtedness and Aggregate Risk." Working Paper w29774. Cambridge, MA: National Bureau of Economic Research. <https://www.nber.org/papers/w29774>.
- IDB (Inter-American Development Bank). 2021a. *Efectos de la corrupción en los contratos de asociaciones público-privadas*. Washington DC. https://www.researchgate.net/publication/332058228_Efectos_de_la_Corrupcion_en_los_Contratos_de_Asociaciones_Publico_Privadas_consecuencia_de_in_enfoque_de_tolerancia_cero.
- . 2021b. *Impacto del COVID-19 en el desarrollo de infraestructura en América Latina y el Caribe y el rol de las asociaciones público-privadas en tiempos de crisis en la región*. <https://publications.iadb.org/es/impacto-del-covid-19-en-el-desarrollo-de-infraestructura-en-america-latina-y-el-caribe-y-el-rol-de>.
- ILO (International Labour Organization). 2022. *Panorama Laboral 2021 América Latina y el Caribe*. Lima. https://www.ilo.org/americas/publicaciones/WCMS_836196/lang--es/index.htm.
- . 2022. *World Employment and Social Outlook: Trends 2022*. Geneva. https://www.ilo.org/global/research/global-reports/weso/trends2022/WCMS_834081/lang--en/index.htm.
- IMF (International Monetary Fund). 2021. *Outlook for Latin America and the Caribbean: A Long and Winding Road to Recovery*. Regional Economic Outlook for Latin America and the Caribbean, October 2021. Washington, DC.
- . 2022. <https://www.imf.org/en/Publications/REO/WH/Issues/2021/10/21/Regional-Economic-Outlook-October-2021-Western-Hemisphere>.
- Kergroach, Sandrine. 2021. "The Digital Transformation of SMEs." Paris: Organisation for Economic Co-operation and Development. <http://www.sela.org/media/3222564/the-digital-transformation-of-smes.pdf>.
- Meléndez, Marcela. 2022. "Presentation of IDB's 2022 Latin American and Caribbean Macroeconomic Report." Comments on the occasion of

- the launch of the 2022 Latin American and Caribbean Macroeconomic Report, Washington, DC, April 8, 2022. https://www.youtube.com/watch?v=SnyKzO_0Jks&ab_channel=Inter-AmericanDevelopmentBank.
- OECD (Organisation for Economic Co-Operation and Development). 2019. *Digitalisation and Productivity: "A Story of Complementarities"*. Paris, France. https://www.oecd-ilibrary.org/economics/oecd-economic-outlook-volume-2019-issue-1_5713bd7d-en.
- Peña, Ignacio. 2021. "Tecnolatinas 2021: The LAC Startup Ecosystem Comes of Age." IDB-LAB Monograph, Washington DC: Inter-American Development Bank. <https://publications.iadb.org/en/tecnolatinas-2021-lac-startup-ecosystem-comes-age>.
- Powell, Andrew, and Liliana Rojas-Suárez. 2020. "Sound Banks for Healthy Economies: Challenges for Policymakers in Latin America and the Caribbean in Times of Coronavirus." Washington, DC: Inter-American Development Bank and Center for Global Development. <https://www.cgdev.org/publication/sound-banks-healthy-economies-challenges-policymakers-latin-america-and-caribbean-times-coronavirus>.
- Rojas-Suarez and Fiorito. 2022. "Growing Smaller: COVID's Impact on Firm Size in Latin America." CGD Notes. Washington, DC: Center for Global Development <https://www.cgdev.org/publication/growing-smaller-covid-19s-impact-firm-size-latin-america>.
- Standard & Poor's. 2022. "Latin American Banking Country-By-Country Outlook First Quarter Of 2022: So Far So Good, But New Risks Emerge". February 17, 2022. S&P Global Ratings Banking Outlook. <https://www.spglobal.com/ratings/en/research/pdf-articles/220217-latin-american-banking-country-by-country-outlook-first-quarter-of-2022-so-far-so-good-but-new-risks-emerg-101202461>.
- United Nations Development Programme. 2021. Regional Human Development Report 2021. New York, New York. <https://www.undp.org/latin-america/regional-human-development-report-2021>.
- World Bank. 2020. *Enterprise Survey Follow-ups*. World Bank. Dataset downloaded from <http://www.enterprisesurveys.org> on February-2022, Washington DC.
- . 2021. *Enterprise Surveys Follow-ups*. World Bank, Washington, DC. Dataset downloaded from <http://www.enterprisesurveys.org> on February-2022.
- . 2022. *Map of SME-Support Measures in Response to COVID-19*. World Bank, Washington, DC. <https://www.worldbank.org/en/data/interactive/2020/04/14/map-of-sme-support-measures-in-response-to-covid-19>.



Center for Global Development

2055 L Street NW
Floor 5
Washington DC
20036

CGD Europe

1 Abbey Gardens
Great College Street
London
SW1P 3SE

Inter-American Development Bank

1300 New York Avenue, N.W.
Washington DC
20577

WWW.CGDEV.ORG
WWW.IADB.ORG

