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Debt Sustainability of Latin American Countries in the post-COVID Economy

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Abstract. Annually growing public debt of Latin American countries is a source of a consistent increase in regional crisis potential. The COVID-19 pandemic has exacerbated political instability and deepened socio-economic imbalances in the region. The chronic dependence on debt financing increases the region's vulnerability to external shocks and makes it much more challenging to implement public policies to achieve the UN Sustainable Development Goals. The purpose of the article is to reveal the increasing nature of the debt risks inherent in the Latin American countries, and to propose measures to overcome them. The authors summarize the views of leading Russian and foreign experts on the debt sustainability of the region. Based on the statistical data of international organizations, regional development institutions, as well as analytical materials published by Bloomberg, Fitch, White & Case or Deloitte, the authors analyze the approaches to solving the Latin American debt problem. However, considering recent debt dynamics, new public borrowings may cause a deterioration of the regional debt sustainability in the future. This issue reinforces the uncertainty in international investment circles regarding the future solvency of the Latin American region. The situation in the Latin American countries is exacerbated by the uncertainty whether positive rates of economic growth resume in the medium term that have been lost due to volatile global commodity prices. The study examines the prospects for regional economic stabilization in Latin America and the Caribbean, including through the use of new debt financing mechanisms to meet current financial needs and minimize the risks of financial vulnerability.

Key words: Latin America, public debt, debt sustainability, public finance, external shocks, international financial organizations

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Долговая устойчивость стран Латинской Америки в постковидной экономике

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Аннотация. Ежегодное увеличение объемов государственного долга стран Латинской Америки является источником последовательного усиления кризисного потенциала в регионе. Пандемия COVID-19 привела к обострению политической нестабильности и углублению социально-экономических дисбалансов в регионе. Хроническая зависимость стран Латинской Америки и Карибского бассейна (ЛАКБ) от долгового финансирования увеличивает уязвимость региона перед внешними шоками и значительно усложняет проведение государственной политики для достижения Целей устойчивого развития ООН. Цель исследования заключается в раскрытии природы и обосновании прогрессирующего характера долговых рисков, присущих латиноамериканским странам в постковидной экономике, а также в предложении мер по их преодолению в современных реалиях. Обобщены взгляды ведущих российских и зарубежных специалистов на долговую устойчивость государств ЛАКБ. На основе статистических данных международных организаций, региональных институтов развития, а также аналитических материалов проанализированы подходы к решению долговой проблемы в странах Латинской Америки. Принимая во внимание долговую динамику прошлых лет, привлечение новых заемных средств с высокой вероятностью негативно отразится на региональной долговой устойчивости в перспективе. Это усиливает опасения в международных инвестиционных кругах относительно платежеспособности Латиноамериканского региона в будущем. Положение латиноамериканских стран усугубляется неопределенностью возобновления положительной экономической динамики в среднесрочном периоде, утраченной в связи с волатильностью мировых цен на сырьевые товары. Углублению региональной рецессии в постковидный период могут способствовать нерешенные проблемы политического и социально-экономического характера, неоднозначные перспективы восстановления экономики и выхода региона на траекторию устойчивого развития, а также слабая предсказуемость будущих экономических шоков. Рассматриваются возможные перспективы региональной экономической стабилизации стран Латинской Америки и Карибского бассейна, в том числе за счет использования новых механизмов заемного финансирования для удовлетворения текущих финансовых потребностей и минимизации рисков финансовой уязвимости.

Ключевые слова: Латинская Америка, государственный долг, долговая устойчивость, государственные финансы, внешние шоки, международные финансовые организации

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Introduction

Ensuring national economic and financial stability in the post-COVID global economy is one of the most pressing topics on the international agenda today. Against this background, the sustainability of a number of economically vulnerable and pandemic-affected countries who cannot support their economies for long without borrowed financial resources is of particular importance. Since servicing often-excessive public debt can become uncontrollable (which is a factor contributing to increasing regional crisis potential) international regulators pay special attention to such countries.

In this regard, both investment and academic communities express concern about the developing economies of Latin America and the Caribbean (hereinafter referred to as LAC) that have historically acted as large borrowers of financial resources in the international debt market. It should be emphasized that even though it was the Latin American region that triggered the international debt crisis in the 1980s virtually no other region of the world has subsequently escaped the consequences of an extraordinary increase in external debt burden while trying to meet urgent financial needs.

Currently, in order to overcome the negative consequences of the pandemic, most countries of the world have increased their debt volumes with the help of the international debt market. As a result, according to the IMF, in 2020 global public debt reached a record level equaling the global GDP.[1] Thus, unprecedented volumes of public borrowing necessary to finance anti-crisis policy have actually become

[1] Fiscal Monitor (October 2022) // IMF. URL: https://www.imf.org/external/datamapper/datasets/FM (accessed: 20.10.2022).

a pattern for all economies globally regardless of their development level. However, not all countries managed to effectively implement macroeconomic stabilization programs. In 2020, during the pandemic, most developed countries and a number of developing countries managed to keep interest rates low and ensure stable functioning of domestic economies. Other countries, including the LAC states, faced problems of a structural nature — initial high levels of public debt prevented new public external borrowing on acceptable terms. As a result, the amount of debt raised to fight the pandemic was significantly lower than that received by developed countries, which was accordingly reflected in the damage the LAC states suffered. These developments necessitate an assessment of the debt risks in the LAC, including from the point of view of their impact on the global economy in the post-COVID conditions.

Preconditions for the Breach of Debt Sustainability in the Latin America

Global practice of anti-crisis management of public finances recommends an increase in government borrowing (in case of insufficient reserves) in order to prevent macroeconomic destabilization following a significant reduction in government revenues and investments. However, this practice in the LAC countries signals significant risks associated with their future solvency.

First, it should be noted that the Latin American region has been developing in economically unfavorable conditions for quite a long period of time. Even before the break-out of the COVID-19 pandemic the region's economy was heavily dependent on highly volatile global commodity prices. At the same time the economies of the LAC were affected by such external factors as the stagnation of international trade (Ocampo, 2015, p. 6), the reduction in international financing, the decline in economic growth rates both within the region and in People's Republic of China, one of the key trading partners and investors (Yakovlev, 2016, p. 121; Zvereva, 2019, p. 173).

Among the internal destabilizing factors there are limited capacity of existing institutional mechanisms to ensure proper public spending discipline, non-execution and (or) weakening of the fiscal rules, increasing inflation, abuse of command and administrative methods, ongoing scandals among the branches of government and growing social tensions (Kuznetsov & Morozov, 2020, p. 162). Given external and internal development imbalances the LAC is the region most affected by the pandemic. It is noted that the reasons for such a devastating effect are primarily related to the presence of permanent structural socio-economic imbalances (Bárcena, 2021, p. 62), the whole complex of which has fully manifested themselves during the COVID-19 pandemic (Yakovleva & Yakovlev, 2020, p. 82).

Thus, the governments of the LAC countries face a simultaneous need to reform healthcare systems, urgently develop anti-crisis measures aimed at stimulating and supporting national economies, refinancing existing public debt obligations while servicing new ones with limited budgetary resources (Cardenas et al., 2021, p. 1). The increased need of Latin American governments for additional financing of anti-crisis measures given reduced government revenues, quarantine measures that paralyzed the real sector of the economy, a sharp drop in aggregate demand and purchasing power of the population, rising unemployment and social unrest (Arellano, Bai & Michalache, 2021, p. 3), resulted in an unprecedented increase in the budget deficits of the LAC countries in 2020—2021 (Fig. 1). These circumstances forced the governments of these countries to carry out public borrowing in international capital markets in much greater volumes than before.[2]

[2] Latin America's Heavy Debt Load Could Spark More Unrest in 2022 // Bloomberg. December 17, 2021. URL: https://www.bloomberg.com/news/articles/2021-12-17/latin-america-s-heavy-debt-issuance-seen-risking-future-unrest (accessed: 11.03.2022).

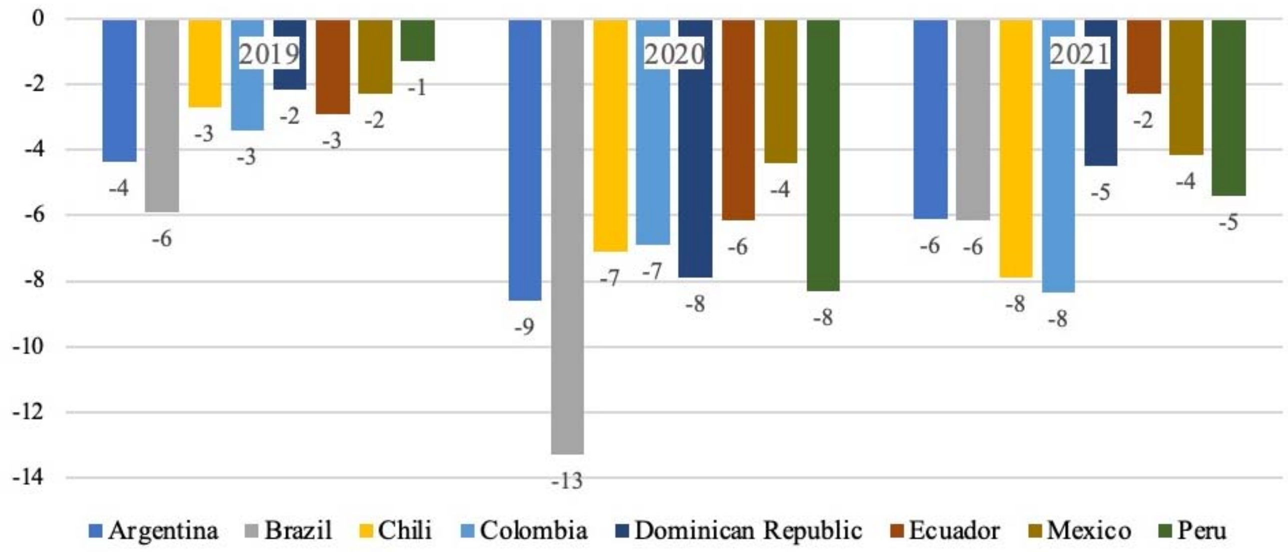

Fig. 1. Budget Balance of Selected LAC Countries in 2019—2021, % of GDP
Source: Fiscal Monitor (October 2022) // IMF. URL: https://www.imf.org/external/datamapper/datasets/FM (accessed: 20.10.2022).

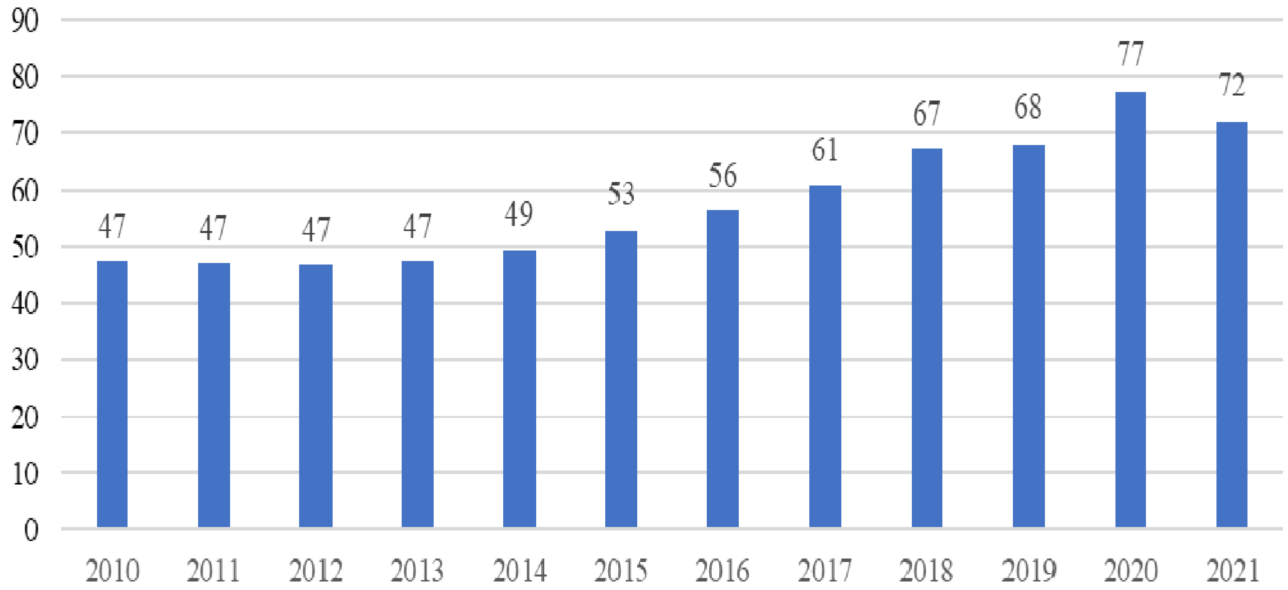

Fig. 2. Public Debt to GDP Ratio of the LAC Countries in 2010—2021, % of GDP
Source: World Economic Outlook (April 2022) // IMF. URL: https://www.imf.org/external/datamapper/datasets/WEO (accessed: 20.06.2022).

This led to a more intense public debt accumulation in Latin America and the Caribbean (Fig. 2).

A sharp drop in output combined with the need to increase public expenses to fight the pandemic has left Latin American countries amassing and continuing to build up an already massive amount of public debt that can jeopardize their sustainable development prospects (Mirabal Cano & García Encinas, 2021, p. 4; Sturzenegger, 2020, p. 7). According to Bloomberg, in 2020, there were six defaults on sovereign bonds in the Latin America, including government obligations of Ecuador, Argentina, Belize and three times more public debt of Suriname. The economies of Mexico, Brazil, El Salvador, Venezuela are also at a risk of insolvency.[3] In addition, a total amount of more than USD 80 billion of government bonds of Latin American countries have been restructured.[4]

Such a dramatic increase in debt given the current trend for increased borrowing by the LAC countries indicates a significant macroeconomic risk of further deterioration in regional debt sustainability (Herrero, 2021, p. 15). According to Fitch Ratings, the US rating agency, the increase in borrowing has only aggravated the region's exposure to shocks. At the same time, the agency predicts a further increase in the total public debt of the LAC countries.[5] However, according to the IMF, in 2021 the public debt to GDP ratio of the LAC countries decreased by 5% (see Fig. 2). According to Deloitte and Fitch Ratings, due to both internal imbalances and international geopolitical tensions the prospects for economic recovery in the Latin American region remain uncertain.[6]

In this regard, it seems appropriate to consider the reaction of international and regional development institutions to the problem of debt sustainability in the Latin American region especially in view of the possible recurrence of the global financial crisis.

The Role of International and Regional Development Institutions in Solving the Debt Problem of the LAC Countries

Socio-economic impact of the COVID-19 pandemic has clearly illustrated the importance of having an additional source of funding amid shrinking government revenue. The ability of countries to quickly mobilize both domestic and external financial resources (including borrowings) without significant consequences for their economies has made it possible to ensure a timely response to the challenges of the pandemic.

However, presently, a few LAC states are in a vulnerable financial position and are increasingly limited in increasing government borrowing including through the emission of government securities on favorable terms. Therefore, the LAC countries are more actively seeking support from international and regional development institutions that are ready to provide additional liquidity. However, the terms of financing and the types of debt instrument are determined by multilateral institutions for each borrowing country independently taking into account the need to overcome the resulting structural imbalances that impede economic growth.

Active cooperation between the LAC countries and international and regional financial institutions during the pandemic was intended to relieve the public debt burden by achieving sustainable economic growth and investment. However, as noted in a special report by the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), international multilateral funding in Latin America was limited.[7] Not all

[3] Latin America Focus: Fall 2021 // White & Case. October 25, 2021. URL: https://www.whitecase.com/publications/insight/latin-america-focus/sovereign-debt (accessed: 25.03.2022).

[4] Six Sovereign Defaults in 13 Months Roil Latin American Markets // Bloomberg. May 12, 2021. URL: https://www.bloomberg.com/news/articles/2021-05-12/six-defaults-in-13-months-upend-latin-america-s-bond-market (accessed: 25.03.2022).

[5] Fiscal Challenges to Persist in Latin America in 2022 // Fitch Ratings. December 7, 2021. URL: https://www.fitchratings.com/research/sovereigns/fiscal-challenges-to-persist-in-latin-america-in-2022-07-12-2021 (accessed: 15.03.2022).

[6] See: Latin America Economic Outlook, June 2022 // Deloitte. June 23, 2022. URL: https://www2.deloitte.com/us/en/insights/economy/americas/latin-america-economic-outlook.html (accessed: 15.07.2022); Latin American Sovereign Ratings Stabilizing below Pre-Pandemic Levels // Fitch Ratings. January 12, 2022. URL: https://www.fitchratings.com/research/sovereigns/latin-american-sovereign-ratings-stabilizing-below-pre-pandemic-levels-13-01-2022 (accessed: 15.07.2022).

[7] An Innovative Financing for Development Agenda for the Recovery in Latin America and the Caribbean // CEPAL. December 3, 2021. URL: https://repositorio.cepal.org/bitstream/handle/11362/47490/3/S2100627_en.pdf (accessed: 13.06.2022).

LAC countries were able to meet their needs with concessional funding from international financial institutions (IFIs) despite the dire consequences of the pandemic in the region. These problems arose because the International Monetary Fund (IMF) and the World Bank directed resources mainly to low-income and lower-middle-income countries. For instance, according to the ECLAC report, in 2020, such states received 75% of available funding from the World Bank through the International Development Association (IDA).[8] Only 7 countries in Latin America and the Caribbean — Honduras, Bolivia, Dominica, Grenada, Saint Vincent and the Grenadines, Saint Lucia, and Haiti — received USD 908 million in concessional IDA funding. The rest of Latin American states received financing only on market terms. Thus, following the pandemic of the LAC countries owed to the World Bank USD 10.2 billion in 2021 in comparison to USD 6.1 billion in 2019.[9] It should be noted that in accordance with the set of rules known as the Washington Consensus the stabilization programs of the World Bank and the IMF in addition to the high cost of servicing are often accompanied by additional requirements for socio-economic and financial policies pursued by the states. These requirements often feature reduced public expenditures. Due to obvious unfavorable socio-economic effects the conditionality of lending through the Bretton Woods institutions was criticized and caused social discontent and protests in the region (Jeifets & Pravdiuk, 2020, pp. 62—64).

At the same time, it was regional development institutions that ensured the prompt provision of the bulk of borrowed funds into the region including the Inter-American Development Bank (IDB), the Corporacion Andina de Fomento — Development Bank of Latin America (CAF), the Central American Economic Integration Bank (CABEI), the Caribbean Development Bank (CBD). In 2020, the CAF emerged as the region's most significant source of external funding providing USD 9.9 billion to help fight the pandemic. The IDB, in turn, provided USD 8 billion in financing, the CABEI another USD 2 billion, and the CBD — USD 0.2 billion (Fig. 3).

The financial support received by the LAC countries from international and regional financial institutions has been used primarily to fund emergency health programs.[10] However, it should be noted that such forms of lending are motivated by the expected recovery of sustainable economic growth. In its absence credit support from IFIs may affect both the growth of government debt obligations of the LAC countries and the cost of servicing these obligations. In addition to historically high government debt the LAC states have accumulated this could further exacerbate the debt sustainability in the region in the long run.

Given the challenging debt situation that many countries find themselves in during the pandemic, the World Bank and the IMF in 2020 called on the G20 to temporarily suspend public debt payments for a number of countries until December 2021. This initiative called the Debt Service Suspension Initiative (DSSI) applied only to the least economically developed borrowers as defined by the UN.[11] Among the LAC countries, only 8 countries (Haiti, Honduras, Nicaragua, Dominica, Grenada, Guyana, St. Lucia, St. Saint Lucia, Saint Vincent and the Grenadines) meet these requirements.[12]

[8] An Innovative Financing for Development Agenda for the Recovery in Latin America and the Caribbean // CEPAL. December 3, 2021. URL: https://repositorio.cepal.org/bitstream/handle/11362/47490/3/S2100627_en.pdf (accessed: 13.06.2022).

[9] Ibid.

[10] Development Bank Financing in the Context of the COVID-19 Crisis in Latin America and the Caribbean // CEPAL. 2022. URL: https://repositorio.cepal.o/bitstream/handle/11362/47882/1/S2100766_en.pdf (accessed: 01.07.2022).

[11] Virtual Meeting of the G20 Finance Ministers and Central Bank Governors Riyadh, Saudi Arabia, April 15, 2020 // G20 Research Group. 2020. URL: http://www.g20.utoronto.ca/2020/2020-g20-finance-0415.html#a2 (accessed: 18.06.2022).

[12] Debt Service Suspension Imitative // The World Bank. March 10, 2022. URL: https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative (accessed: 18.06.2022).

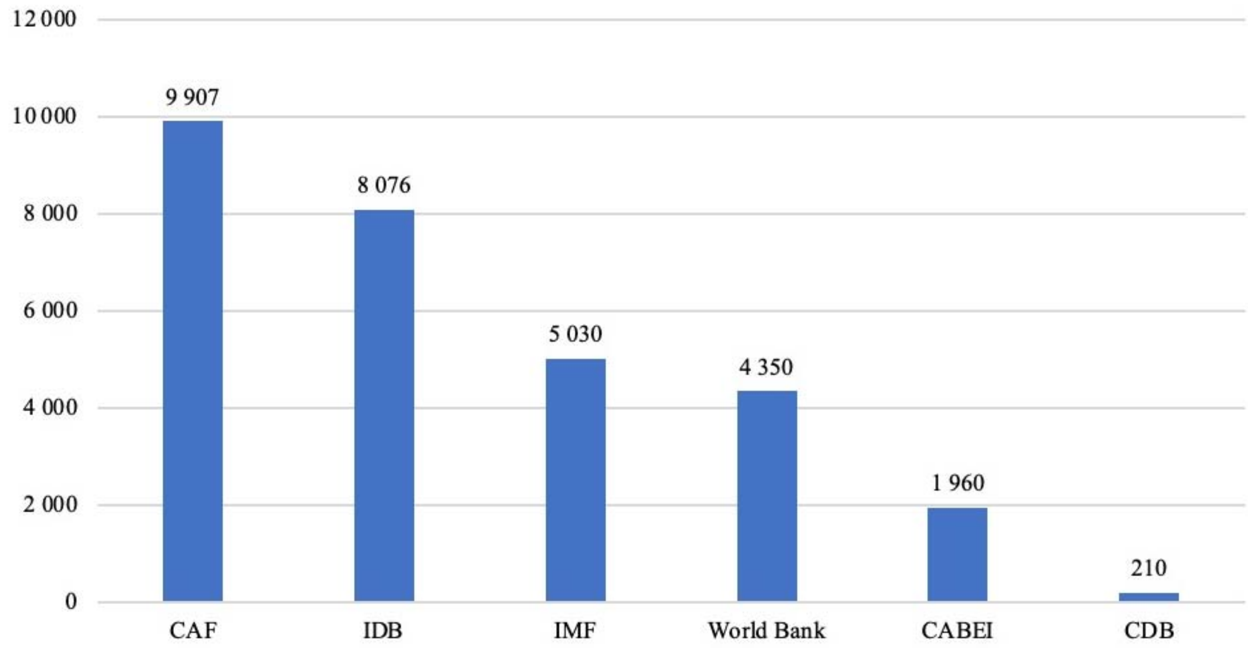

Fig. 3. Total Funding Allocated to the LAC Countries by International and Regional Development Banks to Fight the COVID-19 Pandemic in 2020—2021, USD million

Source: Development Bank Financing in the Context of the COVID-19 Crisis in Latin America and the Caribbean // CEPAL. 2022. URL: https://repositorio.cepal.o/bitstream/handle/11362/47882/1/S2100766_en.pdf (accessed: 01.07.2022).

This initiative was the IFIs' most ambitious project in response to the over-indebtedness of a number of countries during the pandemic.[13] However, it provided only a temporary reprieve and did not offer a long-term solution to over-indebtedness and debt sustainability. Upon the completion of the initiative participants would have to repay the capitalized deferred principal and interest on the debt within five years of the end of the one-year grace period. The delay was designed to ensure that the countries participating in the initiative would have fiscal opportunities not only to withstand the medium and long-term consequences of the pandemic but also to ensure debt sustainability. However, there were no measures or initiatives at the global level that could enable developing countries to grow at a rate that would guarantee the sustainability of their public debt in such a swift manner. Thus, in December 2021, the countries participating in the initiative resumed debt payments despite worsening economic conditions in some of them. As private creditors mainly declined to support this initiative, it was not possible to achieve an improvement in the fiscal capacity of the participating countries and the initiative therefore turned out to be mostly ineffective.[14]

In this regard, the Fund to Alleviate COVID-19 Economics (FACE, also known as the Liquidity Fund) proposed by the Government of Costa Rica in December 2020 at a special meeting of the UN General Assembly could become a more effective tool for resolving the excessive debt of Latin American countries.[15] The fund was designed to mitigate

[13] Debt Service Suspension and COVID-19 // The World Bank. July 28, 2021. URL: https://www.worldbank.org/en/news/factsheet/2020/05/11/debt-relief-and-covid-19-coronavirus (accessed: 19.06.2022).

[14] Ineffective G20 Debt Service Suspension Initiative Ends as World Faces Worst Debt Crisis in Decades // Brettonwoods Project. April 6, 2022. URL: https://www.brettonwoodsproject.org/2022/04/ineffective-debt-service-suspension-initiative-ends-as-world-faces-worst-debt-crisis-in-decades/ (accessed: 01.07.2022).

[15] At UN, Costa Rica Defends International Fund to Alleviate Economic Blow of Pandemic // The Tico Times. September 23, 2020. URL: https://ticotimes.net/2020/

the effects of the pandemic by redistributing liquidity from developed countries to developing ones. Among the main characteristics of the Fund, the following should be highlighted:

– the proposed funds of USD 516 billion (3% of GDP of developing countries or 0.7% of GDP of developed countries);

– provision of preferential loans for up to 50 years;

– freedom of borrowers from fiscal, monetary or other structural conditions (except for the requirements for proper management of the received funding);

– compliance of the Fund's activities with the UN Sustainable Development Goals.[16]

On the one hand, the proposal to provide preferential loans without structural conditions indeed seems to be the most effective. However, on the other hand, an attempt to create a fund similar to the IMF's emergency financing mechanism without restrictive conditions and at the expense of developed countries may turn out to be an uneasy initiative due to the lack interest on behalf of developed economies in providing this kind of gratuitous long-term financing.

Therefore, obtaining emergency credit support from international and regional development institutions is significant and, for a number of countries, the only available mechanism to deal with the consequences of the COVID-19 pandemic. At the same time, if the macro- or microeconomic conditions deteriorate in the short or medium term because of emergency circumstances or unresolved internal structural imbalances in the LAC economies, financial support provided by IFIs on market conditions could launch the next cycle government borrowing. Together with the existing level of public debt in some LAC countries this creates an additional burden on their budgetary systems and increases debt risks.

Decisions that Determine the Region's Development Trajectory

In October 2019, the IMF, in its report on trends and growth prospects for the LAC countries, focused on the uncertainty and unpredictability of the development trajectories of the Latin American region.[17] In a similar report in October 2021, the IMF confirmed earlier disappointing estimates.[18] Pessimistic forecasts are still based on external factors related to weak economic growth such commodity prices and capital flows volatility. Like previously political uncertainty in some large LAC countries is an obstacle to economic growth which results in increased unrest while the pandemic has exacerbated the danger of a regional socio-economic collapse (Zvonova, 2020, p. 9). With this in mind and given the imminent possibility that new internal and external destabilizing factors may emerge, a further increase in public debt without necessary structural changes can only exacerbate the recession in the region.

Thus, the prospects for economic development in the region directly depend on the nature of the current decisions made by the governments. In this regard, World Bank Chief Economist K. Reinhart suggests that developing countries should increase their debt in order to combat the consequences of the coronavirus pandemic but at the same time warns that these countries will later suffer from an

09/23/at-un-costa-rica-defends-international-fund-to-alleviate-the-economic-blow-of-pandemic (accessed: 01.07.2022).

[16] Costa Rica Presents a Proposal for a COVID-19 Economic Relief Fund // CEPAL. September 25, 2020. URL: https://www.cepal.org/en/pressreleases/costa-rica-presents-proposal-covid-19-economic-relief-fund (accessed: 05.07.2022).

[17] Regional Economic Outlook: Stunted by Uncertainty // IMF. October, 2019. URL: https://www.imf.org/en/Publications/REO/WH/Issues/2019/10/22/wreo1019 (accessed: 15.03.2022).

[18] Werner A., Ivanova A., Komatsuzaki T. Outlook for Latin America and the Caribbean: A Long and Winding Road to Recovery // IMF Blog. URL: https://www.imf.org/en/Blogs/Articles/2021/02/08/blog-latin-america-and-caribbeans-winding-road-to-recovery (accessed: 13.03.2022).

unprecedented wave of debt crises and debt restructuring. “First you worry about the war, and then you figure out how to pay for it,” says K. Reinhart implying that the consequences of the pandemic could be much more serious than the consequences of the debt crisis.[19] Meanwhile, it should be borne in mind that the consequences of the debt crisis can be no less catastrophic, from total poverty and unrest to civil conflicts with even more victims.

Consequently, the governments of the LAC countries are now facing an extremely difficult choice: either they pursue a policy of optimizing and redistributing budget expenditures to prevent deterioration in debt sustainability or carry out lax fiscal policy aimed at stimulating economic activity and supporting the most affected sectors of the economy. It is important to note that the costs of economic stimulus policies in developing countries are much higher than in developed ones. Investors’ minimum yield requirements for government securities in developing economies are significantly higher than those for developed countries (Bizuneh & Geremew, 2021). There are also currency risks associated with the devaluation of national currency against the foreign one that the debt obligations are denominated in, which is especially evident during crises. All of the above-mentioned factors lead to increased costs of servicing public debt.

Nevertheless, Latin American countries are likely to continue to increase government borrowing and they may become the largest issuers of government debt among developing countries. Chile, Brazil, Colombia, Mexico, and Peru are expected to continue to address their financing needs including public through additional borrowing in 2022 (Villavicencio, 2021).

If the trend towards increasing public debt in order to stimulate economic growth continues, in the current regional environment this increases the risks of a debt crisis. With public budget balances deteriorating, socio-economic situation aggravating, and the region showing no clear signs of a rapid economic recovery in 2022,[20] significant fiscal adjustments are expected from borrowing countries to minimize debt risks. First, we are talking about reconsidering the spending priorities when a significant part of them is concentrated around financing of healthcare systems. Secondly, there is a need to increase government revenues through tax reforms, for example, by raising taxes on goods that are harmful to health.[21]

It is important to note that government initiatives related to an increase in the tax burden run the risk of provoking civil discontent and protests (Kuznetsov & Morozov, 2020, pp. 164—165), which complicates the policy implementation. Tax hikes are the primary and most effective fiscal instrument at the disposal of the Latin American governments to prevent a debt crisis. However, the inability of governments to use this mechanism forces them to turn to the bond market and intergovernmental loans or to the initiative promoted by development institutions as mechanisms to ensure the stabilization of national economies. It seems that this mechanism has no alternative. The appeal of governments to the international debt market

[19] Borrow to Fight Economic Impact of Pandemic, Says World Bank’s Chief Economist // Financial Times. October 8, 2020. URL: https://www.ft.com/content/0582e495-765a-46a1-98f9-ac48e80a139c (accessed: 20.03.2022).

[20] Latin America and the Caribbean’s Growth Will Slow to 2.1% in 2022 amid Significant Asymmetries between Developed and Emerging Countries // CEPAL. January 12, 2022. URL: https://www.cepal.org/en/pressreleases/latin-america-and-caribbeans-growth-will-slow-21-2022-amid-significant-asymmetries (accessed: 20.03.2022).

[21] Urgent Reforms Needed to Boost Growth and Prevent Another Lost Decade in Latin America and the Caribbean // The World Bank. October 5, 2021. URL: https://www.worldbank.org/en/news/press-release/2021/10/05/urgent-reforms-needed-to-boost-growth-and-prevent-another-lost-decade-in-latin-america-and-the-caribbean (accessed: 16.03.2022).

allows them to provide financial support to the affected national economy without increasing tax rates, introducing new taxes, or reducing tax incentives, and most importantly, without significant budgetary optimization. However, as global practice implies, such a policy leads crisis economies to an even greater economic downturn.[22]

Therefore, the transfer of a growing public debt burden from one government to another can take quite a long time. This process, however, cannot continue indefinitely. As a result, sooner or later, when a risk of a new crisis arises the government faces tougher market conditions and for political and (or) economic reasons finds itself cut off from external financing. The consequences of the financial bubble consisting of government debt obligations accumulated over decades can be catastrophic, both for an individual country and the global economy.

At the same time the very fact of a default is not as catastrophic as the possibility of being left without additional funding due to various economic or political sanctions or in the context of a new unexpected epidemiological threat. No matter how serious the default was, over time new investors would always appear who, rid of various prejudices, would be ready to finance a new cycle of debt financing for a justified premium. However, it is necessary to understand that today external government borrowings can no longer be considered a universal anti-crisis tool given already significant debt burden. In this regard the LAC countries should be encouraged to work out alternative ways of managing the economy with a minimal and safe use of external borrowed capital. In order to ensure continued sustainable development, it is necessary to emphasize the need for domestic structural reforms without handing the problem of a growing debt burden down to future generations.

[22] There is also a third option of using the fiscal reserves but often they are either depleted or their use does not yield necessary returns.

The Need for Reforms and Policy Recommendations

It is certain that the increase in sovereign debt is the subject to regular dispute and has both supporters and opponents. Adherents of the increase of the debt burden consider that it is possible to carry out measures to stimulate the economy and smooth out shocks through borrowed sources simultaneously. For example, during the COVID-19 crisis, sovereign debt served as a tool to mitigate the socioeconomic effects of the pandemic (Morales & Wanderley, 2020). It can also help revive the economy through public investment and spending, and help promote inclusive and sustainable growth (Zavaleta Gonzalez, 2020). However, the economic history of most Latin American countries suggests otherwise: historically the public debt in the region has predominantly limited rather than stimulated development opportunities further increasing their external dependence.[23] Therefore, it should be recognized that public borrowing cannot be a universal tool for solving socio-economic imbalances because of its cumulative and burdensome nature, which in a rapidly deteriorating economic environment can further destabilize national economies. Absence of clear prospects for a quick economic recovery in many Latin American countries makes it important to take measures aimed at preventing debt risks.

Currently, the ongoing COVID-19 pandemic is one of the most disruptive factors burdening the regional recovery process. The COVID-19 pandemic is expected to return with new strains, but it is unlikely reach the scale of 2020—2021 (Murray, 2022, p. 419).

Amidst the ongoing difficult epidemiological situation issues related to the formation and execution of budgets in

[23] La Deuda Pública en Constante Incremento: Reporte de la Deuda Externa e Interna // Fundacion Jubileo. 2020. URL: https://jubileobolivia.org.bo/publicaciones/Revistas-Especializadas/La-Deuda-Publica-en-constante-incremento (accessed: 16.03.2022).

the LAC countries are of particular importance in the context of regional recovery. Scenario forecasting of fiscal policy management can provide a significant improvement in the quality and accuracy of decisions made in a rapidly changing environment. Thus, on the basis of only three forecast options (pessimistic, basic and optimistic) and taking into account various micro- and macroeconomic conditions it is possible to achieve increased responsiveness of the budget system to the needs of national economies. The importance of the scenario forecasting can be illustrated by the example of the initial stage of the pandemic: faced with a challenge requiring non-standard measures the LAC countries, like many others, were not ready to promptly optimize and redistribute budget funds in favor of higher priority areas, which affected the primary anti-crisis packages that turned out to be significantly smaller than expected (Esteves, 2020). On the contrary, LAC governments' prompt action would have made it possible to effectively form such a public fiscal program in the shortest possible time that would have met the challenges of the pandemic at its initial stage.

An equally important role is given directly to fiscal policy measures. Long-term adherence to the policy of fiscal expansion in the context of preventing the deterioration of financial stability is possible only if there are sufficient fiscal reserves. This indicates the need to implement normative budgetary rules to accrue and replenish funds necessary to achieve fiscal stabilization. The examples of such rules in the LAC countries include Chile's copper-prices-based rule (Ffrench-Davis, 2010, p. 6) or Venezuela's oil-prices-based fiscal rule.[24] It should be noted that such fiscal rules are directly dependent on market conditions. When the commodity prices are low they do not contribute to the replenishment of the stabilization funds. Against the two rules discussed above Peruvian fiscal rule stands out, where the variables are the share of the proceeds from privatization, royalties for the exploitation of non-renewable natural resources and advance payments from state concessions (Berganza, 2012; Blanco et al., 2020). In terms of financial stability, Peru's fiscal rule is more robust than those of Venezuela and Chile that are directly dependent on market conditions.

Regardless of the sources that form such fiscal buffers their importance is directly linked to their possible use as a fiscal stabilizer by the Latin American countries that could be enacted without raising tax rates, optimizing public spending, and resorting to additional government borrowing. Such a stabilization instrument if enacted also creates more favorable conditions for government borrowing in the international debt market (Blanco et al., 2020). This is of particular relevance since the LAC states cannot refrain from government borrowing in the short term.[25] In this regard, there is a need for special mechanisms and instruments of debt financing which would not lead to a significant deterioration of public finances in the region.

One of such financial instruments aimed at ensuring swiftness of government borrowing may be closed issuing of government securities intended only for a special category of private financially stable resident corporations. The key feature of this tool is that a state forces the corporations to hand over excess profits on a

[24] See: Puente J. M., Daza A., Rios G., Rodriguez A. The Political Economy of the Budget Process: The Case of Venezuela // IADB. November, 2006. URL: https://publications.iadb.org/publications/english/document/The-Political-Economy-of-the-Budget-Process-The-Case-of-Venezuela.pdf (accessed: 15.06.2022); Rodríguez P., Morales J. R., Monaldi F. J. Direct Distribution of Oil Revenues in Venezuela: A Viable Alternative? // Center for Global Development. September 13, 2012. URL: https://www.cgdev.org/publication/direct-distribution-oil-revenues-venezuela-viable-alternative-working-paper-306 (accessed: 16.06.2022).

[25] Latin America's Heavy Debt Load Could Spark More Unrest in 2022 // Bloomberg. December 17, 2021. URL: https://www.bloomberg.com/news/articles/2021-12-17/latin-america-s-heavy-debt-issuance-seen-risking-future-unrest?leadSource=uverify%20wall (accessed: 11.03.2022).

reimbursable basis. The expected characteristics of such securities are short maturity, lack of a secondary market and below-market coupon yields. As an element of anti-crisis public finances management this mechanism is a compromise between the state which receives additional borrowed liquidity on favorable terms and corporations who are not interested in increasing tax rates.

At the same time there is a proposal to implement an agreement based on a public-private partnership (PPP) approach as an additional mechanism to achieve a reduction in the public debt burden. Thus, in accordance with the agreement concluded, a private resident corporation is entrusted to make a targeted loan to finance a specific government program that will also benefit the issuing corporation. Within the framework of such a mechanism corporate debt becomes a source of liquidity and it is also used in conformity with the government's goals. Moreover, the state does not guarantee this debt because such debt is counted as corporate according to the international methodology of Public Sector Debt Statistics[26] and Government Finance Statistics.[27] Such liabilities do not count on the state balance sheet provided that the issuing corporation is not state-owned. The state, on the other hand, provides exclusive tax and (or) customs privileges that help the issuer to service and repay its obligations. Thus, this proposal may allow to artificially reduce the volume of public debt by increasing the private sector's role in the economy. Such a scheme reduces the public debt burden while it also allows domestic corporations to increase their own incomes.

It should be mentioned that the exclusive privileges given to the private sector should meet the requirements of a market compromise. Thus, duty-free imports can significantly affect market competition. An equally significant factor is that an exemption of a state from a debt obligation implies a loss of tax and (or) customs revenues in the amount of benefits provided to the private sector.

The financial mechanisms and instruments discussed above determine the compromise nature of structural changes aimed at achieving greater regional debt sustainability primarily by increasing the role of private capital in the management of national economies.

Conclusion

In 2020 the world faced challenges that require non-standard responses. In Latin America, the pandemic caused not only human casualties and a health crisis but also a deep structural crisis associated with unresolved socio-economic and political contradictions in the region which negatively affected the state of public finances.

Following the crisis caused by the pandemic the ineffectiveness of the financial and economic policy pursued since 2014 has led to an aggravation of the problems of debt solvency and sustainability of the Latin American region, which is reflected in a series of defaults and an increase in the volume of operations to restructure government debt.

The lack of long-term guarantees of the solvency of a number of LAC countries is widely discussed in the media as well as among specialists from major international financial organizations and rating agencies. Such an information background encourages international investors and creditors to either reduce investment and credit flows to the region or to increase the requested premium for the risk taken. As a result, this contributes to declining debt sustainability in the region. The growing attention of the international

[26] Public Sector Debt Statistics: Guide for Compilers and Users. Washington, D.C. : International Monetary Fund, 2011. P. 319. URL: https://www.elibrary.imf.org/view/book/9781484349762/9781484349762.xml (accessed: 16.06.2022).

[27] Government Finance Statistics: Manual 2014. Washington, D.C. : International Monetary Fund, 2014. P. 207—217. URL: https://www.imf.org/external/Pubs/FT/GFS/Manual/2014/gfsfinal.pdf (accessed: 16.06.2022).

community to these issues directly affects the volumes and conditions of further lending.

In connection with the above, it is possible to minimize the debt risks of the LAC countries through the implementation of the following measures. First, taking into account current uncertainty regarding the speed of future economic development it is important to proceed from scenario planning when forming and executing central budgets, which may significantly increase the efficiency of decision-making in a rapidly changing environment. Second, it is necessary to explore the practical possibilities of increasing the availability of debt financing to the LAC governments through the use of new financial instruments and mechanisms. The measures proposed in this study to improve fiscal policy as well as financial instruments and mechanisms are likely to help achieve a more balanced and sustainable debt policy that combines both a need for the government borrowing on acceptable terms and a reduction of the debt risk for the issuer.

Considering the cumulative nature of political and socio-economic contradictions and imbalances in the Latin American region, resolving the problem of the excessive debt burden of the LAC countries is of paramount importance in terms of preventing the emergence of new hotbeds of debt crisis in the face of increasing global geopolitical tensions and the risks of a recurrence of the global financial crisis.

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