The Latin American and Caribbean Economy in a Post-COVID-19 World

Author: Jade Akhras
With editing by Claire Reardon

Important Note

Given the time-and-context-specific nature of the information presented in this case study, it is important to note that it was written on May 11th, 2020, and all sources are from April 16th and on.

The Latin American and Caribbean Economy before the Pandemic

From the 1980s debt crisis,[1] through the global financial crisis of 2007/08,[2] to the slump in global commodity[3] prices since 2015, Latin American economies have long been highly vulnerable to external shocks. Some might argue that the problem is a structural one.

Throughout the twentieth century, most of Latin America failed to industrialize beyond early-stage light manufacturing and into more advanced stages that enable greater growth. The historical domination of economic and political life by land-owning elites prevented the establishment of a power structure that would allow industrial accumulation. Moreover, the strong position of land-owning classes made it difficult for emerging industrialists to compete over access to state resources. While the continued dominance of unproductive resource distribution had no massive repercussions in the early stages of industrialization, it significantly hindered attempts to achieve capital-intensive industrialization later on. This inability to develop a proper productive sector combined with the economy's growing dependence on primary-commodity exports and services – often linked to tourism – has left most Latin American economies in a vulnerable position where minor changes to the global economy have significant ripple effects domestically.

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[1] The Latin American debt crisis began in the early 1980s, when Latin American countries' foreign debt exceeded their earning power, and they were not able to pay off these debts.

[2] The global financial crisis of 2007/08 began in the U.S. with the widespread unstable practices of financial institutions and a residential real estate bubble (overvaluation of housing). The crisis spread international when American financial markets crashed and its foreign investors took heavy losses. In addition, the markets from which the U.S. imported suffered because during its recession the U.S. could no longer afford to consume imported goods at its previous levels.

[3] A commodity is a basic good that is often used as an input in the production of other goods and services, for which there is little differentiation across producers. Examples of commodities prevalent in Latin American and Caribbean are bananas, sugar, oil, and metals.

The impact of COVID-19 on the global economy is clearly being felt by the Latin American and Caribbean economies. However, it is important to note that the region's economies were already in a period of economic weakness and macroeconomic vulnerability. In the decade following the global financial crisis – from 2010 to 2019 – regional GDP[4] growth dropped from 6% to 0.2%. In fact, the growth in the 2014-2019 period was the lowest recorded since the 1950s.

Moreover, the region has little room to increase fiscal spending currently due to high debt, rising interest payments,[5] and limited tax revenue. Firstly, the accumulation of fiscal deficits[6] in Latin America – 2.7% on average in the past decade – increased the central governments' gross public debt.[7] The weight of this debt is evident not just in central governments but also in non-financial public enterprises,[8] which inevitably increases the pressure on fiscal policy[9] space. These enterprises are strategically important given their size, contribution to tax revenue, and involvement in production and exports. Secondly, higher interest payments limited the resources available for development. For example, on average, interest payments rose from 1.8% of GDP to 2.5% of GDP, but health spending barely rose from 1.9% in 2010 to 2.3% in 2018. Thirdly, for Latin America and the Caribbean as a whole, fiscal space has shrunk due to limited public revenue. The revenue's stagnation stemmed from a variety of factors: the slowdown of economic activity, tax evasion, tariff[10] reductions amid trade liberalization efforts, the decline of international commodity prices, and increasing levels of foregone tax revenue through concessions of free zones and the maquila[11] sector.

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[4] Gross domestic product, or the total value of goods and services produced in a given country in one year. GDP is the most commonly used metric for the size of a nation's economy.

[5] Interest is the charge for borrowing money, usually expressed as an annual percent of the amount borrowed. For borrowing countries, this is owed to international purchasers of their debt or, especially for developing nations or unstable markets, international financial institutions such as the World Bank and International Monetary Fund (IMF). Latin American and Caribbean countries also have access to development financing from the Inter-American Development Bank (IADB).

[6] What a government owes in any given year, the difference between its total income and total expenditure for the year

[7] Cumulative deficit, or the total amount of what a government owes to date

[8] A business firm solely or partially owned by the national government and managed through a public authority

[9] One component of economic policy, comprising government action – adjustments in tax rates and public spending levels

[10] A tax imposed by one country on the goods and services imported from another country

[11] A maquiladora, or maquila, is a company that allows factories to be largely duty free and tariff-free

Furthermore, the region's central banks' efforts to stimulate aggregate demand[12] have resulted in historically low interest rates, but with little effect thus far.[13] Aiming to lower lending rates and boost domestic credit, the monetary authorities focused on increasing liquidity[14] by cutting monetary policy rates and expanding monetary aggregates. These efforts were complemented by interventions in foreign-exchange markets in order to mitigate external account deficits and exchange-rate pressures.[15] Despite the efforts, lending rates remained broadly stable and credit to the private sector contracted in real terms (see figure 5). The lack of results reflects how difficult it is for monetary policy to soften the impact of low growth on credit risk[16] and agents' willingness to increase their consumption and investment. Or to put it simpler, international and domestic individuals and businesses don't want to invest in a low-growth economy (because returns will be low), and citizens of a low-growth economy don't have the money for high consumption spending. It is also important to note that high level of private sector debt – households and private non-financial firms – have impacted the policy's effectiveness.

COVID-19 Enters the Region and its Response

The novel coronavirus landed in Latin America and the Caribbean on February 26th after a São Paulo resident returned from a business trip in Northern Italy, ill. Since then, the disease has spread to every country in the region. Latin American and Caribbean countries have a total of approximately 260,000 confirmed cases. The death toll has climbed to around 14,000. Countries across the region have taken an array of actions to tackle the economic and social consequences of the pandemic.

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[12] Total demand for final goods and services produced by an economy, measured by the total amount of money exchanged for those goods and services

[13] Central banks indirectly control the supply of money in an economy, not by printing bills, but by changing reserve requirements for banks, by indirectly setting interest rates to either encourage or discourage lending and borrowing, and by buying and selling government bonds. Increasing the money supply usually brings about an increase in GDP, so during a recession, a central bank will lower reserve requirements, aim for low interest rates, and/or buy government bonds. This is the other component of economic policy, called monetary policy.

[14] Market liquidity is the degree to which a market, such as a country's stock market, allows assets to be bought and sold at transparent, stable prices. A market is considered more liquid when the difference between the prices buyers are willing to pay and the prices sellers are willing to accept is small.

[15] A current account deficit occurs when the value of a country's imports exceeds the value of its exports. A country can use the foreign exchange market to reduce this by selling its currency (increasing the supply to drive down the price, or exchange rate) so that it's cheaper for other nations to import its goods. This is called currency devaluation.

[16] The possibility of loss resulting from a borrower's failure to repay a loan

For country-specific responses and daily-updated case and death reports for the region, please visit this website by the American Society/ Council of the Americas.

Latin American and Caribbean countries have taken immediate measures to contain the virus, protect the workforce, and guarantee household income. Some of these measures include travel restrictions (both to and from the country) and monitoring of travelers, flight bans and border closures, distance learning and homeschooling, total or partial quarantine with working arrangements, and social distancing with closure of restaurants, bars, cinemas, the encouragement of teleworking and reducing office hours. Measures also aim to strengthen health sector capacity given that the health infrastructure across the region is fragmented and insufficient. On average, there are just over 2 beds per 1000 people. Other measures seek to protect the workforce and reduce the social impact on people with lowest incomes through wage support to offset loss of income via advance payments, strengthening unemployment benefits, and the suspension or reduction or payments for water, gas or electricity services. Several measures target small to mid-size enterprise (SMEs), other companies, and the informal sector aim to provide special financial support by renegotiation and improving conditions for bank loans.

Countries have also taken monetary and fiscal measures to avoid the collapse of the economic system. Firstly, monetary authorities have taken measures to increase liquidity[17] by lowering legal reserve requirements[18] and monetary policy interest rates. However, doing so risks further destabilizing domestic currencies against the dollar thereby increasing the cost of imports;[19] this is a risk governments are gradually leaning into. In an effort to prevent illiquidity from turning into insolvency,[20] monetary authorities have announced assistance to financial institutions, especially through short-term loans. Secondly, countries have introduced tax relief measures and applied tax exemptions for certain sectors. Thirdly, countries have increased intervention on the

[17] Liquid assets are cash or an asset that can be readily converted into cash.
[18] The amount of cash that banks are required to have on hand in the case of sudden withdrawals
[19] If a country's money supply increases, its GDP will also increase, which leads to an increase in price levels (inflation). This means that the country's currency will appreciate, so goods will be more expensive to other countries and exports will decrease. However, this increase in money supply is accompanied by a lower interest rate, which means investors will move money abroad to get a higher return – a decrease in the demand for the country's currency. This lower demand means an overall depreciation of the currency relative to other currencies, which makes importing more expensive for the country.
[20] This refers to the concept of accounting liquidity. An illiquidity crisis occurs when a person or business is worth more than its debts, but its wealth is tied up in illiquid assets that would take some time to convert to cash (e.g. property). In contrast, an insolvency crisis is when "what it owes" exceeds "what it owns" – even if the entity could sell all its assets, it still wouldn't be able to pay off its debts.

foreign-exchange market,[21] not to reverse currency depreciations that have already occurred, but to mitigate volatility.[22] Finally, it is important to keep in mind that the fiscal stimulus measures[23] taken in response to the humanitarian and economic crisis will substantially widen fiscal deficits and increase debt levels in many countries. Accordingly, out of close to a 100 countries that have requested emergency funding from the International Monetary Fund, 16 of them are from Latin America and the Caribbean. Additionally, other countries in the region have requested augmentation of existing programs, such as Honduras.

The Impact of the Pandemic on the Latin American and Caribbean Economy

The COVID-19 pandemic has impacted the region through a combination of domestic and international factors which is expected to lead to the most severe contraction in economic activity that the region has experienced since records began in the 1900s.

At the global level, the virus has impacted the region through five channels: reduction international trade, fall in commodity prices, lower demand for tourism services, intensification of risk aversion and worsening of global financial conditions, and reduction in remittances. To begin with, the volume of world trade has plummeted: the World Trade Organization estimates a fall of anywhere between 13% and 32% in 2020. The volume of global trade was following a decreasing trend before the pandemic; it was mostly due to the build-up of trade barriers since early 2018 and its effect on global value chains (GVC). This was about to change with the signing of the "phase one" agreement between China and the United States before the pandemic hit and ended the short-lived optimism. In addition to causing the disruption of GVCs, the pandemic has caused problems for China: once it resumes production, it will encounter difficulties exporting to countries that are going through the pandemic with a time lag.[24] This will cause one of the world trade's main players

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[21] The global market for trading currencies, which determines determines the foreign exchange rates for every currency

[22] This can be done via buying and/or selling its own currency in the foreign exchange market to influence supply and demand, and therefore the price, or exchange rate.

[23] Fiscal stimulus measures are fiscal policy actions intended to stimulate a nation's economy, such as tax cuts or government-funded programs

[24] The basic idea is that China faces reduced demand from Latin America and other regions that were hit by the pandemic later. So world trade is contracting as a whole because China exports in such high volumes. Perhaps this could be more directly related back to Latin America by stating directly that the region, which was hit by the virus later than Asia, Europe, and the U.S., imports a significant amount of capital goods, consumer goods, electronics, etc. from China. At the same time, the reverse is true. Latin America is facing reduced demand for its commodities from trade partners that have been impacted by the coronavirus (like the U.S., European countries,

to experience reduced demand for its exports, thereby amplifying the negative impact on the global volume of trade. This drop in global economic activity, especially in the United States, Europe and China, is hurting prices and trade volumes in LA and the Caribbean which are part of the GVC, through commodities. The value of the region's exports could fall by nearly 15% with an 8.8% drop in prices and a 6% decline in volume.

As previously stated, the region's economies are heavily dependent on commodity exports thereby making their economies especially vulnerable to fluctuations in commodity prices. This year alone, oil prices contracted by over 50 per cent, and they are now standing at their lowest level since 1973 (US$ 22 per barrel). Coal prices fell by 55 per cent, the tradable value of copper decreased by 21.3 per cent, lead by 14.6 per cent, zinc by 19.4 per cent, and soy beans by 7.7 per cent. Brazil, Colombia, Mexico, Ecuador, and Venezuela are heavily dependent on oil revenues. Colombia is the world's fifth largest coal exporter, and Chile constitutes the largest copper exporter. Peru depends on copper, zinc, and lead exports. The drastic decrease in commodity prices decreases the region's value of exports which increases the trade deficit.[25]

The deterioration in global financial conditions is as bad as in the 2008-2009 global financial crisis. Volatility of capital flows has increased to record levels. There have been massive capital outflows[26] from emerging markets. Most currencies have depreciated against the dollar.[27] There have been sharp increases in sovereign risk.[28] Latin America has faced reduced financing from the World Bank and IMF (of almost $80 billion compared to 2019), which has led to a slowdown in growth and development, which has made the region less attractive to foreign investors and thereby reduced foreign investment.

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and China), which lowers commodity prices. Another reason world trade and Latin American trade are contracting.

[25] Every country has either a trade deficit or a trade surplus, depending on the dollar value of its imports and exports. If exports exceed imports, the nation has a trade surplus; if imports exceed exports, it has a trade deficit.

[26] Capital outflow is the movement of assets out of a country, often in response to economic or political instability. Capital outflow happens when foreign and domestic investors, believing that better opportunities exist abroad, sell off their holdings in a particular country.

[27] A currency depreciates when its value compared to the value of another currency decreases. If a currency depreciates against the dollar, this means that more of that currency is required to exchange for one dollar.

[28] Sovereign risk refers to the possibility that a national government will default on its debt or implement foreign exchange controls that will significantly reduce the value of its debt payments.

Tourism is one of the most affected sectors. Its recovery will depend on how and when borders will reopen across the world. Tourist arrivals globally are expected to fall between 20-30%. In a scenario with a 30% decrease in tourism revenues in 2020, GDP would fall by 0.8, 0.3, and 2.5 points in Mexico and Central America, the Caribbean, and South America respectively. The decline in tourism in the Caribbean will have a significant impact on employment, household incomes, and government revenues since the sector employs 2.4 million people. The effects of this decline will also be particularly felt by micro and small enterprises, which represent a significant proportion of the hotel and restaurant sector: 99% of enterprises and 77% of employment.

Remittances[29] to Latin America and the Caribbean could contract by 10-15% and could take between 4 and 8 years to return to levels observed in 2019. This is because in main destination countries for migrants from the region, such as the U.S., the pandemic is adversely affecting sectors that traditionally employ migrants in high numbers, such as restaurants, construction, and hotels. In several LA and Caribbean countries, these flows make a significant contribution to economic activity. Between 80% and 90% of remittances are used to cover basic needs of the recipient households. Therefore, the contraction in remittances will have a major impact on poverty and consumption in the region.

As for the domestic impact of the pandemic, this is principally due to the government-imposed quarantines. In the absence of vaccines, efforts to control the pandemic are focused on restricting the movement of people, which affects production activity to different degrees, depending on the sector. Quarantine and social isolation have led to slumps in certain sectors such as aviation, tourism, commerce, and free zones. Companies are facing substantial falls in revenue, which has led to difficulties in obtaining credit, and an increased likelihood of insolvency. Sectors may be divided into three groups, according to the degree to which they are likely to be affected by containment measures:

- The least affected: agriculture, hunting, livestock, forestry and fishing
- The moderately affected: mining and quarrying, electricity, gas and water supply, construction, financial intermediation, manufacturing industries, business and rental services, civil service, real estate, social and personal services.

[29] Remittances are payments sent or transferred to another party, here and typically used to mean money sent by someone working abroad to family members back in her home country.

- The most affected: repair of goods, hotels and restaurants, wholesale and retail, transport, storage and communications, services in general.

Growth Projections for 2020

The Economic Commission for Latin America and the Caribbean (ECLAC) forecasts that the LA and Caribbean economy will contract by 5.3% in 2020, increasing the number of poor by almost 30 million. ECLAC also projects that South America will contract -5.2% because several countries will be affected by lower activity in China, an important market for their exports. The organization predicts a -2.5% contraction in the Caribbean due to reduced tourism services and a -2.3% decrease in Central America due to reduced economic activity in the US, which is its main source of remittances and its principal trading partner.

ECLAC predicts that the value of the region's exports will fall by 15%. The biggest impact will be seen in South American countries that specialize in exporting commodities and are therefore more vulnerable to a drop in their prices. The value of exports from Central America, the Caribbean and Mexico will suffer the impact of a deceleration in the United States' economy.

A significant deterioration in labor indicators is expected in 2020. The unemployment rate is seen reaching around 11.5%, marking an increase of 3.4 percentage points versus 2019 (8.1%). Thus, the number of unemployed persons in the region would rise to 37.7 million. Furthermore, any increase in employment that SMEs could provide, since they are usually responsible for more than 50% of formal employment, is stymied by the harsh impact of the pandemic on these enterprises.

The poverty rate[30] in the region is expected to increase to 4.4% in 2020, going from 30.3% to 34.7%. This means that almost 30 million more people will find themselves in situations of

[30] The Economic Commission of Latin America and the Caribbean (ECLAC) measures poverty by blending two different approaches used internationally. The first is the method of food-energy intake, or the level of expenditure that allows for compliance with minimum nutritional requirements. This defines the poverty line as the expenditure associated with a basket of food that satisfies the United Nations Food and Agriculture Organization's (FAO) nutritional requirement of 2,100 calories per day (with discrepancies by age, sex, activity, etc.). The second method is the cost of basic needs, which builds upon food-energy intake by including non-food necessities. The monetary line is constructed through multiplying the food bundle by the Orshansky Coefficient (the inverse of food expenditure as a portion of total expenditure). ECLAC measures extreme poverty using the food-energy intake method and non-extreme poverty using the cost of basic needs.

poverty. Extreme poverty is expected to rise by 2.5%, rising from 11.0% to 13.5%, which entails an increase of 16 million people.

The Post COVID-19 World: Structural Effects

The COVID-19 global pandemic has drastically altered social and economic relations. Its consequences will far outlast the health crisis. According to ECLAC, it is highly likely this global crisis will accelerate changes that were already unfolding in the configuration of global production and trade. The pandemic has exposed the vulnerabilities of interdependence between countries and between firms. This may eventually lead to significant changes in the global organization of production.

First of all, it has grown increasingly apparent just how vulnerable international production networks are to unforeseen phenomena, and consequently, how much more resilient these networks have to be. For multinational corporations that are the main players in these networks, this means diversifying networks of suppliers across firms and countries, nearshoring[31], and relocating critical processes when feasible. In the world's major economies, there are, in fact, already signs of movement in this direction.

Second of all, this crisis and its quarantining countermeasures have forced firms to adapt their internal operations. Accordingly, automation and the mass use of teleworking platforms have become more efficient, cheaper, and easier to implement. This may result in the accelerated shift towards automation in some sectors and production processes, with impacts on employment.

Third of all, the pandemic has dealt a powerful blow to multilateralism and international cooperation. This is exemplified in the export restrictions on medical and health products and foodstuffs adopted by at least 60 countries in a variety of regions. There is also an observed trend in shrinking international supply networks. Consequently, the main players in global trade governance will likely focus their efforts towards regional – instead of multilateral – agreements. The net result will not be a reversal of globalization, but a more regionalized world economy.

The impact of these global structural shifts and the consequent responses will vary between Latin American and Caribbean countries depending on the production structure of each economy,

[31] Transferring a business operation to locations closer to end markets

on existing production capabilities, and the depths of its firms' involvement in GVCs. According to ECLAC, "as never before in the past 30 years, the region's prevailing model of engagement with the international economy —based on specialization in raw materials, assembly manufacturing and sun and sea tourism— is open to discussion today."

Discussion Questions

These questions can be tackled in class, perhaps in debate form in order to stimulate discussion. Whether the students should answer these questions before or after the simulation is at the teacher's discretion.

1. After reading about all of the various economic challenges that the region faces, what challenge(s) do you think are the most pressing? If you were an economic minister of a particular country (You can choose!) what would you focus on in your fiscal policy? If you were head of that country's central bank, what would be your monetary policy?

2. Given the current global debate about health security vs economic freedom, if you were in a position of power in any Latin American or Caribbean country in the current pandemic, how would you weigh this health-economic tradeoff most politicians are currently facing?

3. What is the role of international organizations in helping developing countries overcome these economic hurdles? Should these organizations be able to condition the aid they give? If so, how do countries preserve their sovereignty?[32] Should they? (In this question, the instructor should briefly go over some organizations that handle aid, including the WorldBank, IADB, and IMF.)

4. Is there any realistic way that things could have unfolded differently for the region during this pandemic, keeping in mind that the end is still unwritten?

[32] The complete power and right of a governing body over itself, free from interference of outside bodies or actors

5. Can you foresee a global economic order where Latin American and Caribbean countries are no longer dependent on further developed/industrialized countries to purchase their commodity goods and sell them manufactured goods? How would that come about?

Simulation

"As the pandemic spreads across the region, its nature as a health, economic and social crisis is increasingly evident. The extent and duration of its effects, although still too uncertain to quantify, are becoming clearer. It will result in the region's worst economic and social crisis in decades, with damaging effects on employment, the fight against poverty and the reduction of inequality." – ECLAC COVID-19 Special Report No. 2.

The scenario:

The Latin American and Caribbean Economic System (SELA) is holding a meeting for one of its Action Committees aimed at post-pandemic economic planning. The meeting is in present time and the goal of the representatives is to leave the meeting with a feasible action plan that countries in the region will be able implement once the pandemic subsides in order to re-invigorate their struggling economies.

SELA is an intergovernmental organization that groups 26 Latin American and Caribbean countries with headquarters in Caracas Venezuela. Its current membership includes Argentina, Bahamas, Barbados, Belize, Bolivia, Brazil, Colombia, Cuba, Chile, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Dominican Republic, Suriname, Trinidad & Tobago, Uruguay and Venezuela. SELA is primarily aimed at creating a forum for consultation and coordination amongst Latin American and Caribbean countries in order to adopt common positions and strategies on economic issues.

SELA's Action Committees are flexible cooperation mechanisms that are set up when more than two Member States voice interest in promoting projects in certain areas. In this case, the simulation takes for granted that the Action Committee for Post-Pandemic Economic Planning has already been set up. There is no specific set up for how the meeting unfold (i.e. no set rules of procedure). In fact, the simulation itself does not require a given format, simply discussion amongst participants and a moderator to make sure that the session remains productive.

It is important for the participants to not only think of a short term/reactive action plan, but also think of long term/proactive solutions that could include a restructure of economic systems. As the ECLAC report mentioned, the region is now able to restructure how it engages with the international economy (no longer just be the supplier of commodity goods). The participants should think about if and how that might take place.

The aim of this simulation is for participants to immerse themselves in the reality of a global pandemic by taking on the role of one of the region's leaders, collaborating with other leaders, working through large amounts of data, critically engaging with the material in the booklet, and thinking outside the box in order to come up with innovative solutions for the economic crisis the region is facing.

Participants should not solely rely on the information in this booklet. Further research, on the participants' given countries, on the nuances of their responses, and for updated data given the constantly changing landscape of this pandemic, is highly encouraged. It is also encouraged that participants come with potential solutions already prepared; however, the simulation must end with an action plan that is approved by supermajority (two-thirds). While participants might be collaborating with others for a region-wide approach, it is important for each representative to keep in mind the situation and interests of the country they are representing.

This is meant to be a two hour long simulation.

Please keep in mind the following two quotes by Alicia Barcena, the Head of ECLAC:

"We must prepare for the post-COVID-19 world. We must think about the region's future in the new economic geography given the elevated dependence on imported manufactured goods. Industrial policies are needed that would allow the region to strengthen its production capacities and create new capacities in strategic sectors."

"To have an impact in the new global economy, the region must move towards greater regional integration in terms of production, trade and technology. Our countries' coordination on macroeconomic and production matters is crucial for negotiating the terms of the new normal, particularly with regard to an urgent aspect of the current crisis and in the medium term: the issue of financing for a new development pattern with equality and environmental sustainability."

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Recommended Research Sources

For more information about fiscal and monetary policy: Federal Reserve Bank of St. Louis

For background on Latin America as a commodity-exporting region: Latin America in 2018: Why Commodities Are Still King

For descriptions of the IMF, World Bank, and IADB: Understanding the difference between the IMF and World Bank and IADB: About Us

For data on China-Latin America trade relations: Product Imports/Exports by China from/to Latin America & Caribbean 2018

For a deeper dive into regional poverty: Economic Commission for Latin America and the Caribbean: Poverty

For definitions of economic terms and explanations of economic concepts: Investopedia, Finimize