

Fiscal policy reform in Latin America: an alternative view
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Mr Braun provides a strong case for his thesis and we find much common ground with his views. However, we feel that he describes the challenges too narrowly, and we believe that fiscal policy is a key instrument to achieve high, sustainable and equitable growth.

The challenge: We are less pessimistic than Mr Braun regarding recent progress to address the challenge of consolidating fiscal solvency and reducing procyclicality. We suggest putting greater emphasis on the efficiency and equity of taxation and public spending to make further progress on the broader challenge we identify.

There are a number of specific challenges. Public expenditure needs to be rebalanced towards investment, and the efficiency of these outlays must be improved. Although the public sector wage bill in the region is about the average for developing countries, the quality of services is relatively poor and greater value for money needs to be achieved. Social spending needs to be more efficient and better targeted. Currently, educational outcomes are relatively poor, and the majority of spending benefits accrue to the better-off. Finally, the tax systems need to be both more progressive and less distortionary to reduce inequality and boost international competitiveness.

The root causes of the region's fiscal problems: We are in broad agreement with Mr Braun that the root causes of the solvency and procyclicality problems are economic volatility and politico-economic institutional factors. We strongly support the idea of producing rigorous evaluations of cost-benefit and redistributive impact of government projects and programs.

But we believe more attention should have been paid to other underlying causes of poor fiscal policy, in particular budget rigidities. These have negative consequences on budget management, including: limiting the reallocation of public spending as needs change, introducing an in-built bias towards higher spending and taxation, and producing distortions in the tax system in an effort to overcome constraints. They also limit the scope for countercyclical policies and provide little incentive to make public spending more efficient.

There are a number of arguments to support introducing budget rigidities but, beyond a certain point, their costs outweigh their benefits. The underlying cause of budget rigidities is usually a deep political conflict in the budget process, and a permanent solution requires the reform of budget institutions.

Proposed solutions and quantification of costs and benefits: Calculating costs and benefits of fiscal reforms is difficult, and it is possible that some of the solutions proposed by Mr Braun have a one-off impact on the level of GDP without affecting long-term growth.

We agree with the estimate of benefits for *the use of contingent debt instruments to improve debt management*. However, Mr Braun does not explicitly consider the placement cost of non-standard instruments, for which there may be little demand. *Consolidating the budget process by adopting fiscal rules* can be useful, but should not introduce unnecessary rigidities. In our view, reducing budget rigidities should improve the efficiency of public spending.