The Experience with Fiscal Adjustment in Latin America and the Caribbean: Lessons for Brazil
Roadmap for presentation

• Fiscal adjustment in LAC

• Brazil: Basic fiscal arithmetic

• Fiscal procyclicality
FISCAL ADJUSTMENT IN LAC
Fiscal situation is rather fragile: 31 out of 32 countries in LAC with fiscal deficit in 2017

Sources: World Bank staff estimates (March 2018) when available, otherwise WEO (October 2017).
... which keeps adding fuel to already high levels of debt

Brazil's Debt-to-GDP ratio as end of:
2014: 56.3
2015: 65.5
2016: 69.9
2017: 74.0

LAC Average: 57.6%

Sources: World Bank staff estimates (March 2018) when available, otherwise WEO (October 2017).
... and leading to worse credit ratings (i.e., more costly borrowing)

Sources: World Bank staff estimates (March 2018) and Fitch Ratings.
Does the region need to adjust?

• No doubt about that!

• Persistent fiscal deficits and high levels of debt endanger the region’s formidable gains over the last 15 years in terms of:
  • Low inflation
  • Reduction in poverty and inequality
  • Expansion of the middle class
  • Inclusive growth

• Fiscal adjustments would ensure:
  • In the long-run, lower inflation and higher long-run inclusive growth
  • In the short-run, lower debt allows countries to access international credit markets more often and at lower cost
  • In the short-run, it creates fiscal space for future countercyclical fiscal policies and frees resources to face future risks
Are there short-run costs?

• Yes; there is no such a thing as a free lunch

• But, short-run costs vary *a lot* depending on:
  
  • **Speed of adjustment**: gradual far better than shock
  
  • **Spending cuts versus tax increases**: reduce spending unless tax burden is very low
  
  • **What category of spending is cut**: reduce public consumption (public investment and social transfers should be protected)
The costs of gradual fiscal adjustment are substantially lower than those of shock adjustment.

Total cost of fiscal adjustments (in terms of output loss) since 1960

Source: Authors’ calculations based on Global Financial Data, MOxLAD, WDI, and WEO (October 2017).
Costs of spending cuts are lower than that of tax increases (except for very low taxation countries)

Cost in terms of output per unit of adjustment (fiscal multipliers)

Sources: Authors’ calculations based on data from CEPAL and Gunter et al. (2018)
The costs of cutting public investment or social transfers are very high.

Cost in terms of output per unit of adjustment

Source: Authors’ calculations based on data from CEPAL. Note: For the case of Europe, the multiplier for social transfers is statistically zero.
The perils of fiscal adjustment in low inflation environment

Source: Authors’ calculations based on Global Financial Data, MOxLAD, WDI, and WEO (October 2017).
BRAZIL: BASIC FISCAL ARITHMETIC
## Brazil: Primary and total fiscal deficit

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<tbody>
<tr>
<td>Primary Balance</td>
<td>-1.6</td>
<td>-2.0</td>
<td>-2.5</td>
<td>-1.7</td>
<td>-2.3</td>
<td>-1.8</td>
<td>-1.1</td>
<td>-0.5</td>
</tr>
<tr>
<td>Total Balance</td>
<td>-8.1</td>
<td>-10.3</td>
<td>-9.0</td>
<td>-7.8</td>
<td>-8.3</td>
<td>-8.3</td>
<td>-7.9</td>
<td>-7.6</td>
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Source: WEO (IMF, April 2018)
Increase in primary surplus needed to keep debt-to-GDP ratio constant

Note: The increase in the primary surplus needed to keep the debt-to-GDP ratio constant is computed as the DSPB ratio (Debt Sustainability Primary Balance), equal to 4.9 percent of GDP, minus the current primary balance. Sources: Authors’ calculations based on data from World Bank estimates and WEO.
Increase in primary surplus needed to achieve a constant debt-to-GDP ratio consistent with investment grade in 10 years

Note: The target debt levels are the predicted values consistent with the Fitch versus debt regression illustrated earlier. Sources: Authors’ calculations based on Fitch Ratings, World Bank estimates, and WEO.
Brazil’s primary balance path for different scenarios

DSPB Scenario

Investment Grade Scenario

As percentage of GDP

Note: DSPB stands for “Debt Sustainability Primary Balance.” Sources: Authors’ calculations based on Fitch Ratings, World Bank estimates, and WEO.
Brazil: Public expenditure multiplier

Note: Public expenditure includes wages, goods and services, and public investment. Sources: Authors’ calculations based on data from CEPAL.
Non-linear impact of tax changes: LAC vs. Europe

Brazil’s Tax Multiplier: -3.9

Source: Gunter et al. (2018).
FISCAL PROCYCLICALITY
LAC: Cyclicality before and after 2007

Note: Cyclical components are calculated using the Hodrick-Prescott filter. Source: WEO (IMF, April 2018).
Brazil: Procyclicality at the sub-national level (2000-2017)

Sources: Secretaria do Tesouro Nacional (STN) and Ministry of Finance, Brazil.
Procyclicality and institutional quality: Chile versus Brazil

Note: Cyclical components are calculated using the Hodrick-Prescott filter. Sources: ICRG and WEO (IMF, April 2018).
Conclusions: Progress and challenges

• Good news:
  • Region now engages in fiscal gradual adjustments
  • Inflation outbursts of the past are no longer used to dilute wages and social transfers

• Challenges:
  • Preserving social achievements
  • Not relying on cuts to public investment (especially infrastructure)
  • Focusing on cutting unproductive/inefficient spending
English and Spanish version, and Portuguese overview of fiscal adjustment report available at http://hdl.handle.net/10986/29666


Thank you!

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