It’s not just Brazil

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DEALING WITH higher public deficits in a weak economy is a problem that is not unique to Brazil. Carlos Mulas-Granados of the IMF’s Fiscal Affairs Department pointed out recently that today this is a global concern. In its April 2016 World Economic Outlook, the IMF revised world growth estimates down to 3.2%, down from 3.4% January, and suggested that in many countries lower tax revenues could play against efforts to balance public finances. “This is a trend that can be seen in both advanced and emerging economies,” he said. Among growth estimates revised downwards are those for the US (from 2.6% to 2.4%), the Euro Area (from 1.7% to 1.5%), and Japan (from 1.0% to 0.5%). For Brazil, the projection was already negative for growth in January, with growth falling by 3.5%; now the estimated drop is further, to 3.8%

According to the IMF, in developed economies public debt-to-GDP ratios are approaching levels not seen since just after World War II. These countries, Mulas-Granados said, have the triple challenge of managing low growth, low inflation, and high debt. Of 34 economies analyzed by the IMF, 24 had carried out fiscal tightening in 2011, compared to just 8 still tightening in 2016. The reasons why fiscal policy seems to be loosening vary, he said. For instance, Germany and Austria have loosened because their fiscal position is strong, France to stimulate growth, and Portugal because of fiscal tightening fatigue.

In emerging markets, the level of public debt has already surpassed that in the global crisis of 2008–09, and the IMF considers oil-exporting countries to be at greatest risk. “Between 2013 and 2015 in Bolivia the fall in tax revenues resulting from low commodities prices reduced
Bolivian GDP by 6 percentage points,” Mulas-Granados said. Throughout Latin America, he added, there is concern about the deterioration of international prices for minerals and agricultural products. He also warned that “The region faces a significant increase in investors’ risk aversion generated by doubts about the medium-term sustainability of public finances, which is reflected in the fall in confidence of consumers and businesses.”

**Perverse debt dynamics**
Ricardo Martner of the tax affairs unit of the United Nation’s Economic Commission for Latin America and the Caribbean pointed out that there have been several episodes of contingent liability problems in Latin America’s history as a result of exchange rate depreciation, subnational debt defaults, and the weight of the 1980s debt crisis on the financial system. Yet although these have been addressed by specific policies, in his opinion contingent liabilities are still underestimated. “We continue to think that such things do not need much attention, about which there is no need to worry,” he said—which does not encourage the market to have a more positive assessment of fiscal risks of the region.

Martner noted that today Latin American debt is in some ways less worrying than the debt dynamic was not too long ago: “In the 1990s the region had far worse public debt. Today, however, the increasing debt of subnational governments and state-owned companies is not clearly reflected in policy goals and that is

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**IMF projects increasing public debt in Latin America over the next five years**

worrying.” In addition, public debt has been growing because of the “snowball effect” of deteriorating economic growth and rising costs of debt service—a problem particularly troubling for Brazil.

Despite the cloudy world outlook, Mulas-Granados said, the IMF is somewhat more optimistic about the potential to reverse this situation than are the markets. “It is not yet an alarming scenario, but it requires vigilance,” he said, adding that most countries have sufficient tools to reverse this situation. For advanced economies, the recommendation is to increase spending to stimulate growth, investing in innovation, infrastructure, and education. In Latin America, the IMF points out, the focus should be on restoring confidence in fiscal policy. Although there is no single recommendation that would fit all countries, Mulas-Granados said, countries should consider policies that have proved successful in the past, such as stimulating investment by reducing the cost of capital, as Malaysia did in 1989, and making public investment more efficient, as Tanzania did in 1998. He also offers Latin American economies the same advice as for developed countries: increase productivity by encouraging innovation, prioritize public investment in R&D, and offer tax incentives for the private sector. “When it comes to innovation, our advice is never cut spending,” he said. To ensure success, however, monitoring the effectiveness of such measures is essential, as is ensuring that they complement, rather than replacing, private investment, he said. He explained that “a study of advanced countries showed that every 0.4% of GDP public investment in tax credits and subsidies for R&D meant 40% additional investment from the private sector, generating a 5% increase in GDP in the long term.”

For Latin America, the important point is that fiscal adjustment needs to be done gradually over the medium term, Martner agreed, adding that “it is important to draw attention to fiscal multipliers, which are high in the region. During recessions, the effect of fiscal policy on growth may be relevant. Procyclical policies are harmful in times of recession.” He argued that it takes time to bring public finances back into balance and requires discussion of macrofiscal rules—something particularly important for Brazil. Martner pointed out that “Chile, Ecuador, and Colombia have adopted structural fiscal rules for the medium term that take into account cyclical aspects of the economy. Now it is important that Brazil adopt a medium-term fiscal framework that is not affected every month by the credibility of policies and people.”