

The impact of democratic transitions on budgeting and public expenditures

A Latin American perspective

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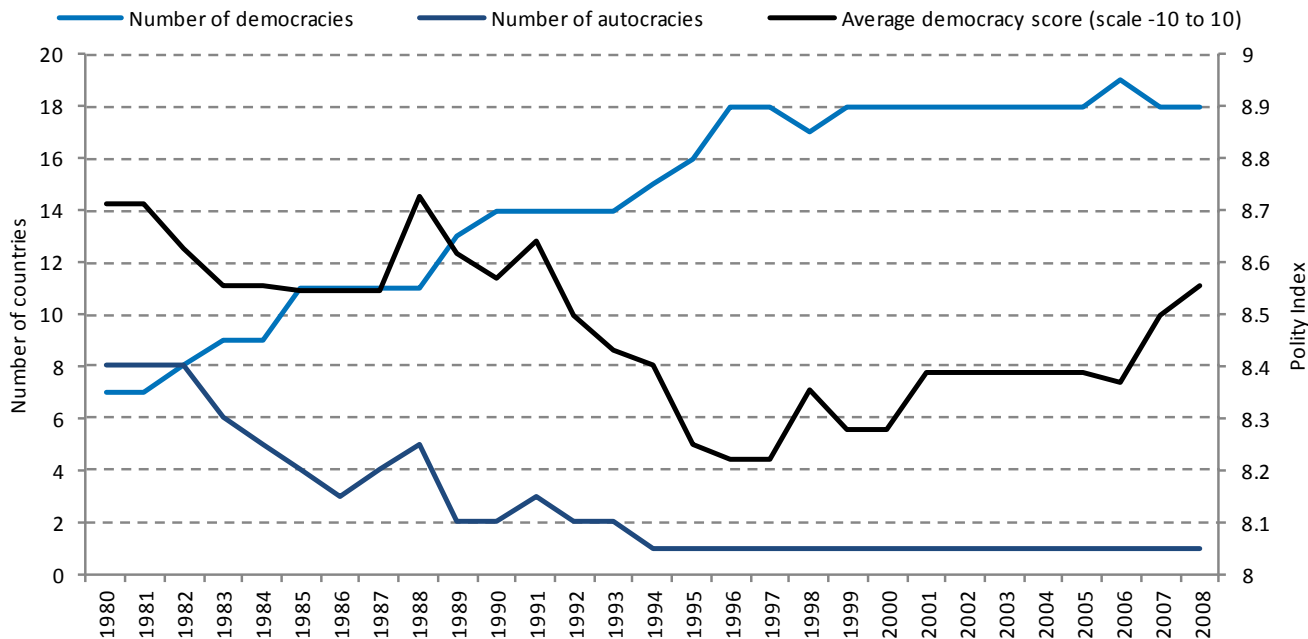
Democratic transitions, budgeting and public expenditures

Sharing experiences from **Latin American...**

- Democratic transitions: **quality** matters (and takes time)
- Risks from **fast responses** to pressing social demands
- The challenging **political economy** of fiscal policy
 - Low taxation, limited redistribution and weak tax morale
 - Transitions as windows of opportunity
- **Good practices** in fiscal policy making
- The emerging **middle class** and their expectations
- Next decade's challenge: a ***state for development***

Democratic transitions: quality matters (and takes time)

Democratic consolidation in Latin America and the Caribbean



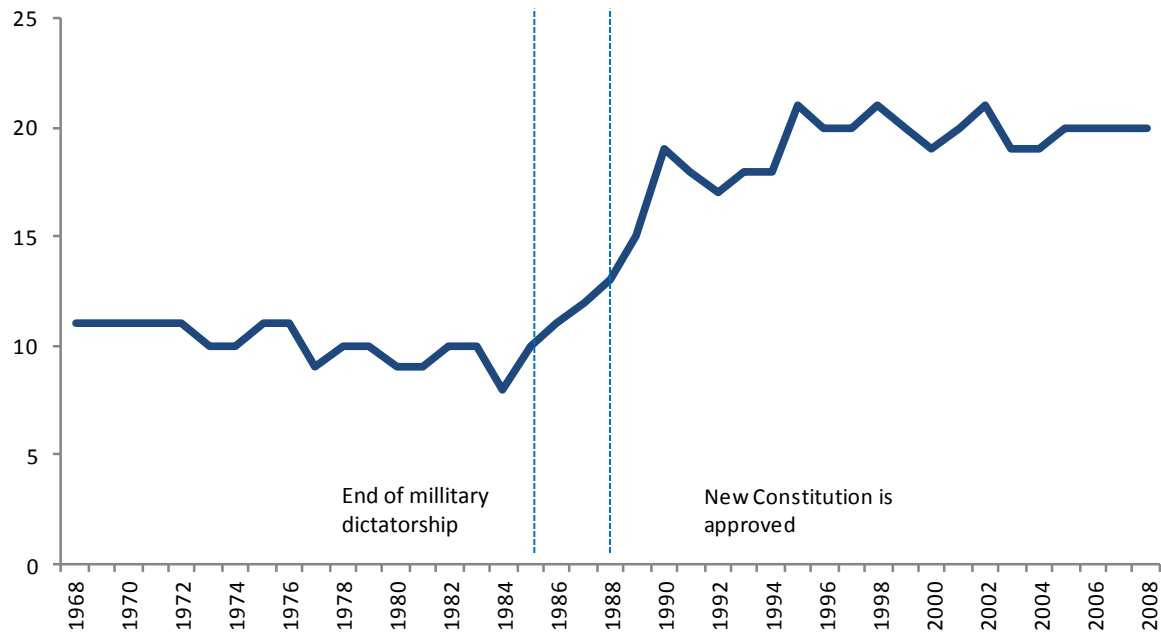
Notes: Following the criteria of Marshall and Cole (2009) countries are classified as a democracy if their Polity score is greater or equal to six

Source: Daude and Melgizo (2010), based on the Polity IV database, accessed in May 2010

Democratic transitions make visible *institutional weakness* which demand time (and political determination) to be solved

Risks from fast responses to social demands

Democratic transition in Brazil and government consumption (% GDP)

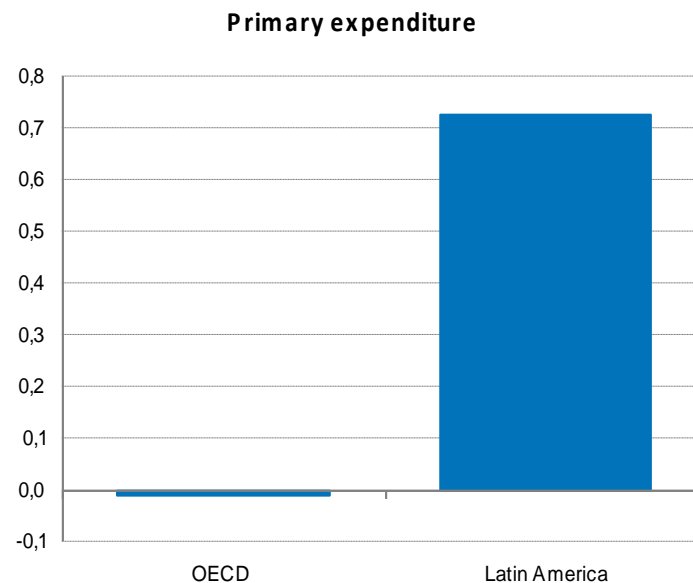
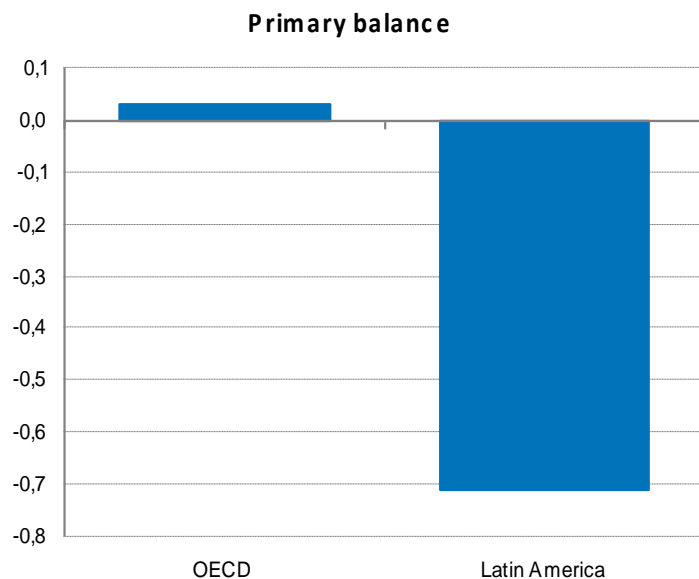


Source: OECD (2010b), based on the World Development Indicators database

Gradual responses to social demands allow avoiding permanent economic imbalances (start with strategic programmes, easy to administrate)

Risks from fast responses to social demands

Impact of elections on fiscal policy in OECD and Latin America, 1990-2006 (% GDP)



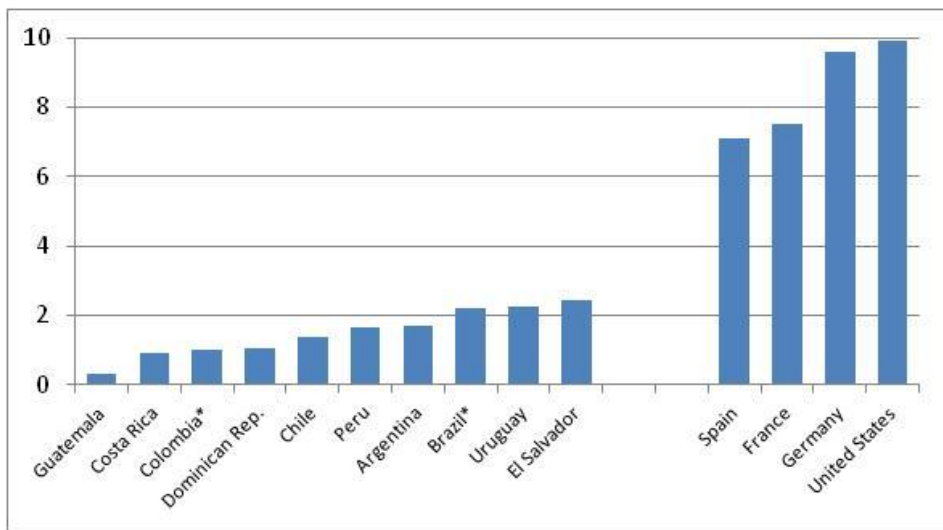
Note: Calculated as the difference between the fiscal variable (as a proportion of GDP) during the election year and prior non-election years

Source: Nieto Parra and Santiso (2009)

Young political systems are vulnerable to electoral-based decisions (presidential elections can be associated with **fiscal volatility)**

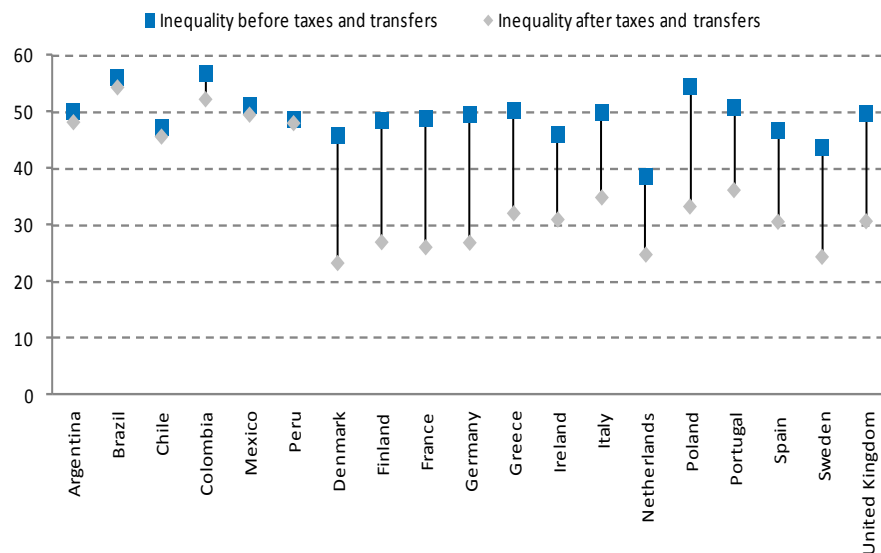
The challenging political economy of fiscal policy

Personal Income Tax in LAC vs. OECD, 2008
(% GDP)



Source: OECD Revenue Statistics and Revenue Statistics in Latin American ECLAC-CIAT-OECD (forthcoming)

Income inequality pre/post taxes-transfers, 2000s
(Gini coefficient)

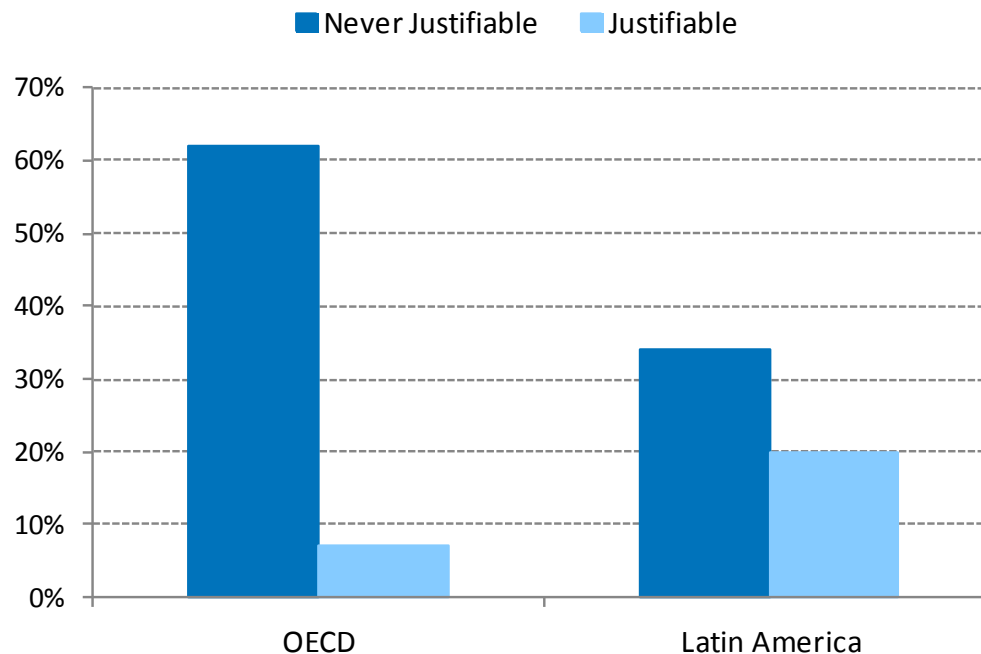


Source: OECD (2011)

Despite the **medium voter** theorem, Latin America has traditionally shown low tax collection, high inequality...

The challenging political economy of fiscal policy

Tax morale in Latin America and OECD countries ("Do you think cheating on taxes is justifiable?")

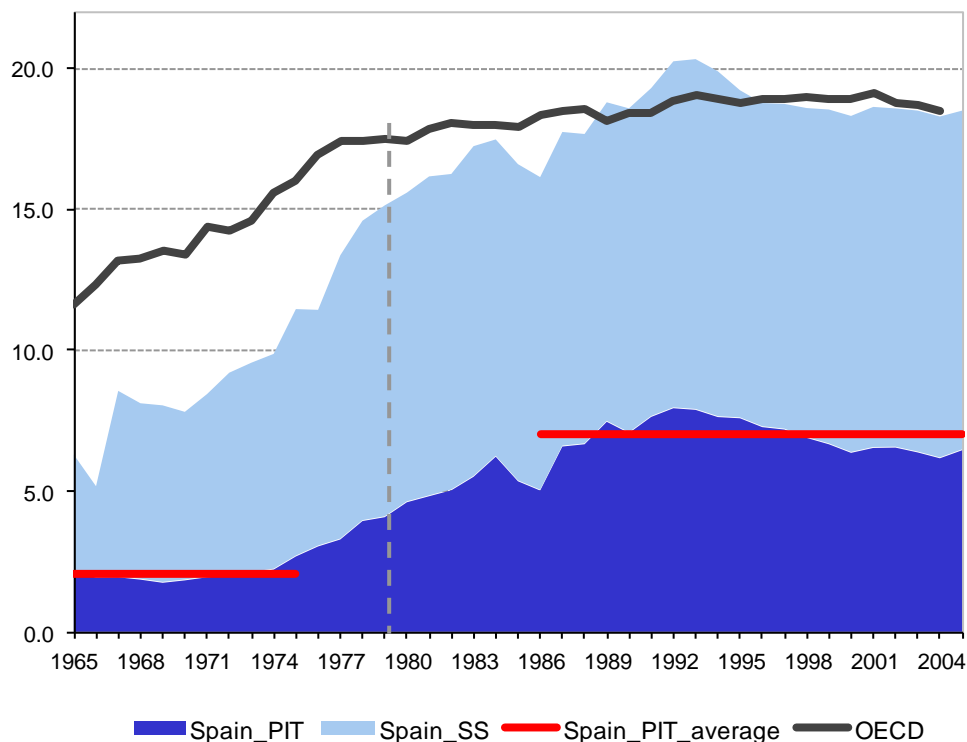


Source: Daude and Melguizo (2010), based on Latinobarometro and World Value Survey

... and a **weak social contract** between citizens and the state

Transitions as windows of opportunity

Direct fiscal tax burden in Spain and OECD countries
(% GDP)



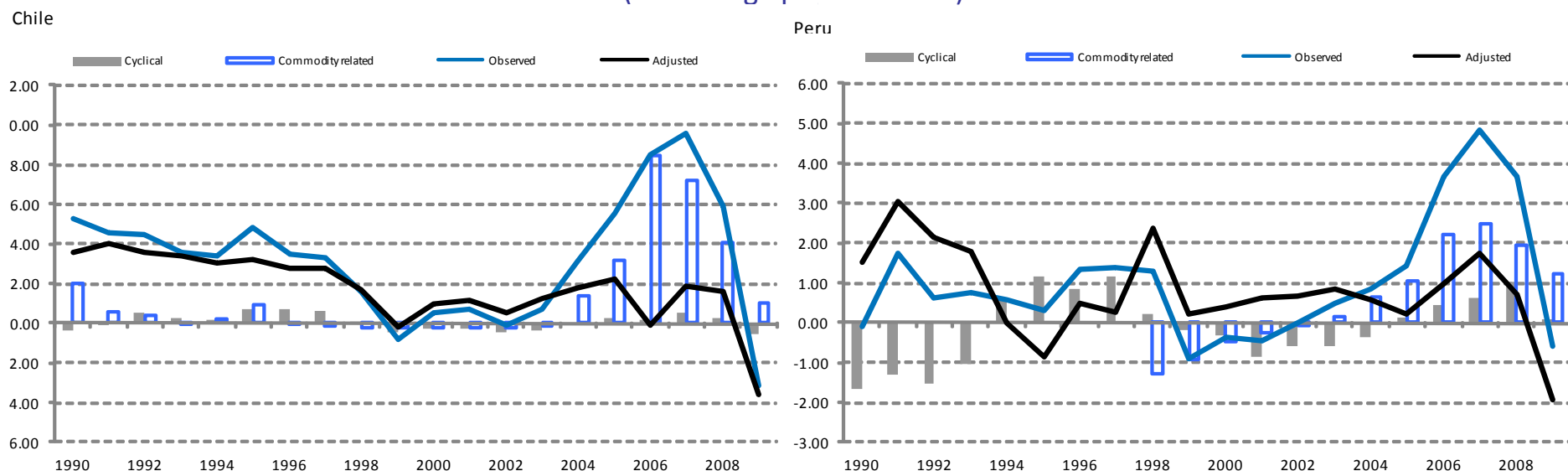
Source: OECD Revenue Statistics

Some factors making tax reform happen:

- Solid research and analysis
- Framing the tax reform
- Transparency and effective communication
- Peer pressure
- Leadership and electoral mandate

Good practices in fiscal policy making

Adjusted primary budget balance (Percentage points of GDP)



Note: General government primary budget balance is adjusted for deviations of GDP and commodity prices (round their trends)

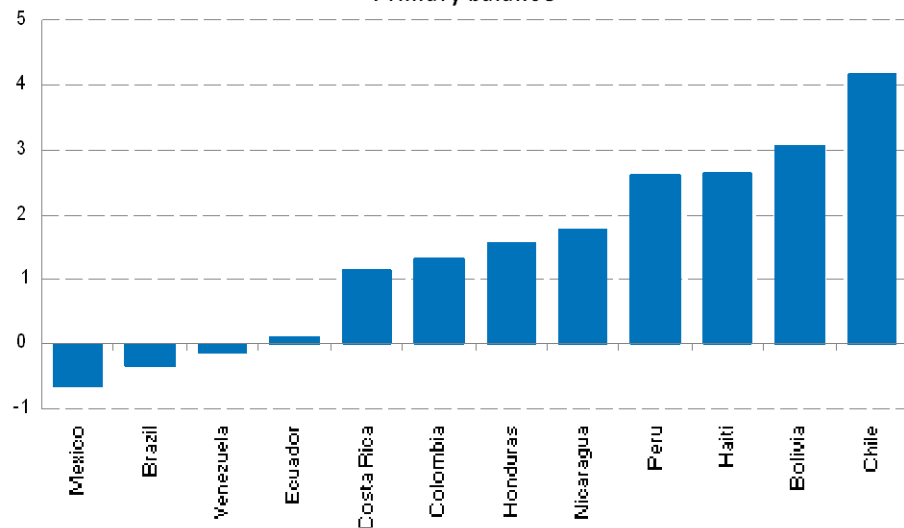
Source: Daude et al. (2010)

Innovative policies (e.g. PPP in infrastructures, fiscal rules, social protection, conditional cash transfers), based on **accumulated experience**

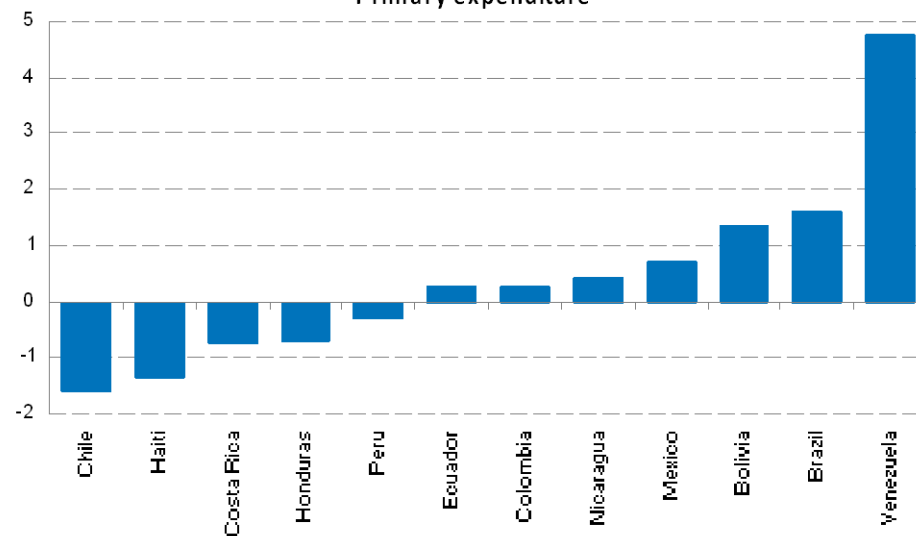
Good practices in fiscal policy making (*electoral cycles update*)

Impact of 2006 presidential elections in LAC on fiscal policy (% of GDP)

Primary balance



Primary expenditure



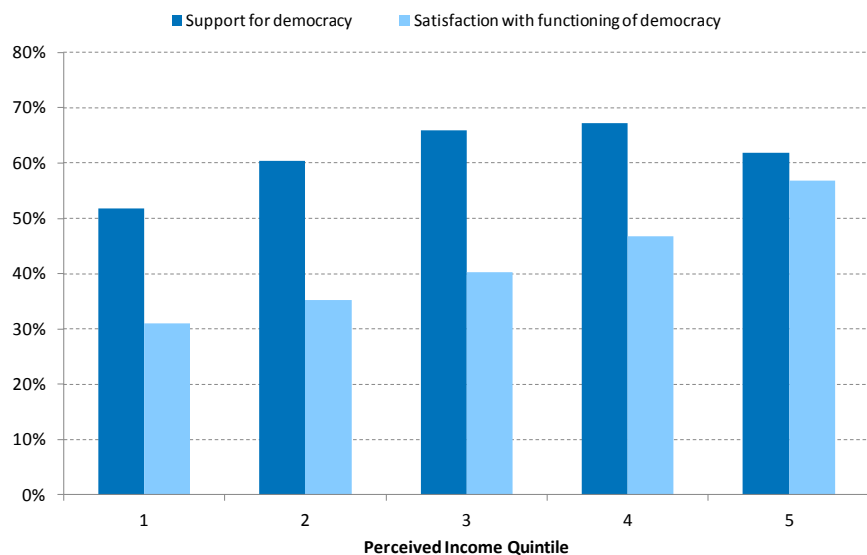
Note: Calculated as the difference between the fiscal variable (as a proportion of GDP) during the election year and prior non-election years

Source: Nieto Parra and Santiso (2009)

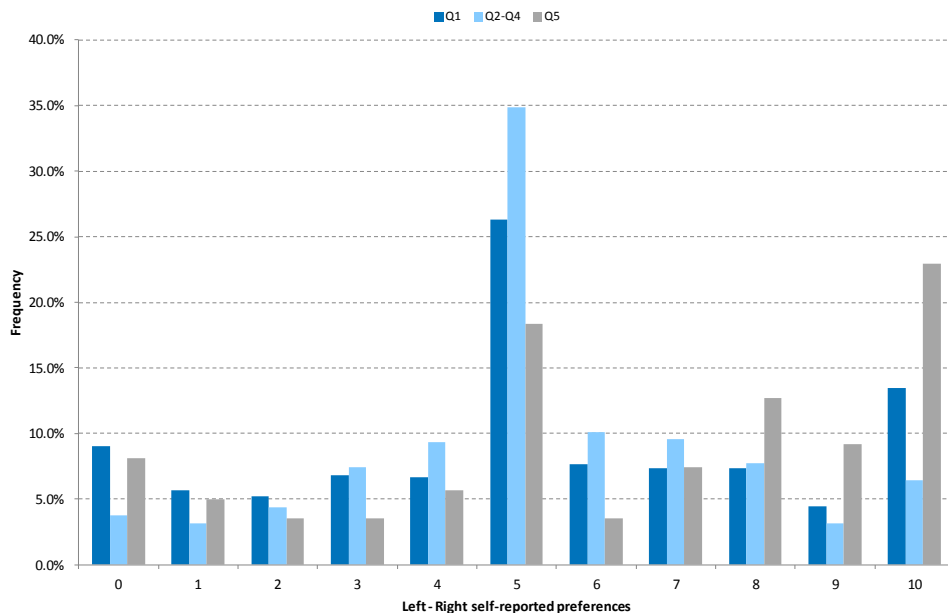
The 2006 round of elections showed significantly a **better performance**

The emerging middle class and their expectations

Attitudes towards democracy (% support and satisfaction)



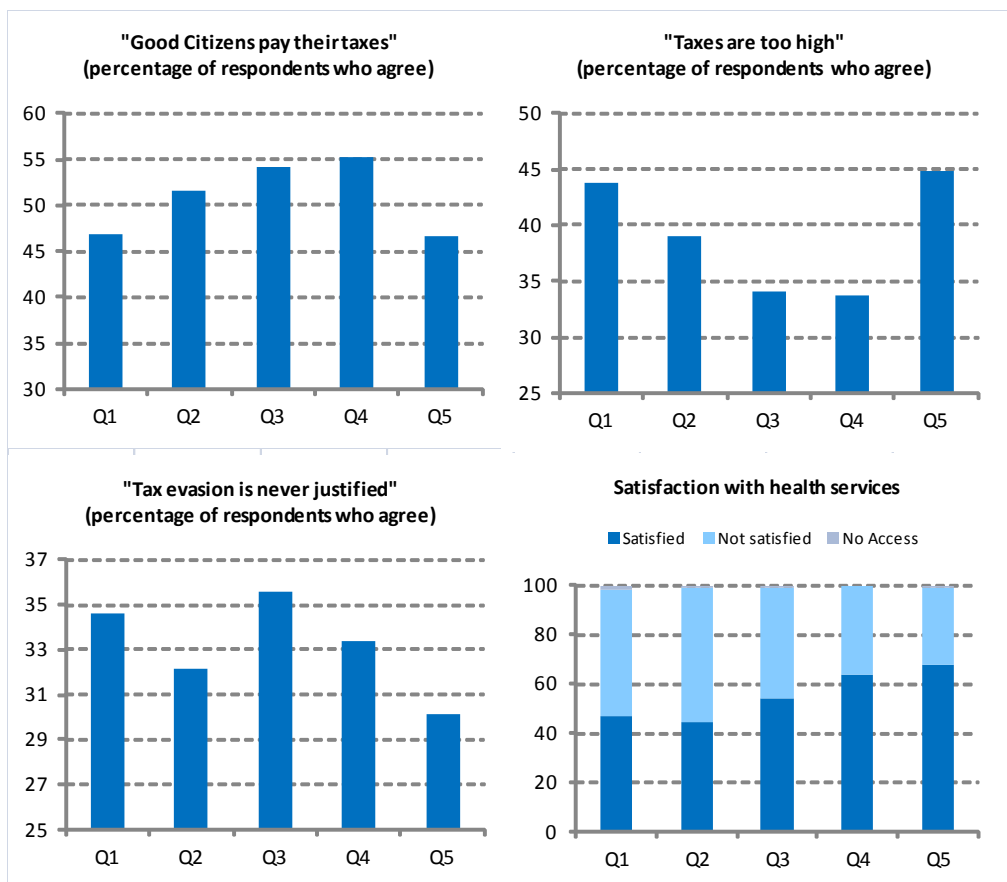
Distribution of political preferences (0 extreme left, 1 extreme right)



Source: OECD (2010b), based on Latinobarometro

Growing **middle sectors** are the main supporters of democracy (but not much satisfied), and politically moderate

The emerging middle class and their expectations



How middle class is Latin America?

- Risk of downwards mobility
- Relatively outside the social contract (low taxed and not fully benefiting from education nor health)

Source: OECD (2010b)

Their demands for better 'advanced' services , less inequality, and institutions free of corruption evolve very rapidly

Next decade's challenge: a *state for development*

Challenges for public policies in Latin America:

- Rebuild **macro 'resiliences'** (institutions), compatible with long-term needs
- Strategic **planning** (anticipate demands and challenges; productive policies)
- Implement ambitious **fiscal reforms** (more/better taxation and benefits)
- Increase efficiency, effectiveness and **transparency** in the public sector
- Involve the **middle class**
- Towards a **fiscal pact**, monitored and evaluated

Democratic transitions, budgeting and public expenditures

... to North Africa and the Middle East

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