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 Melguizo (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)

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)

Despite the medium voter theorem, Latin America has traditionally shown low tax collection, high inequality...
The challenging political economy of fiscal policy

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

**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
Transitions as windows of opportunity

Some factors making tax reform happen:

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

Source: OECD Revenue Statistics
Good practices in fiscal policy making

Adjusted primary budget balance
(Percentage points of GDP)

Chile
Peru

Cyclical Commodity related Observed Adjusted
Cyclical Commodity related Observed Adjusted

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)

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)

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

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

*Source: OECD (2010b), based on Latinobarometro*
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)

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

Source: OECD (2010b)
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

- 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 challenge: a state for development
Selected references


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