

# The impact of democratic transitions on budgeting and public expenditures

## A Latin American perspective

**Ángel Melguizo**

OECD Development Centre



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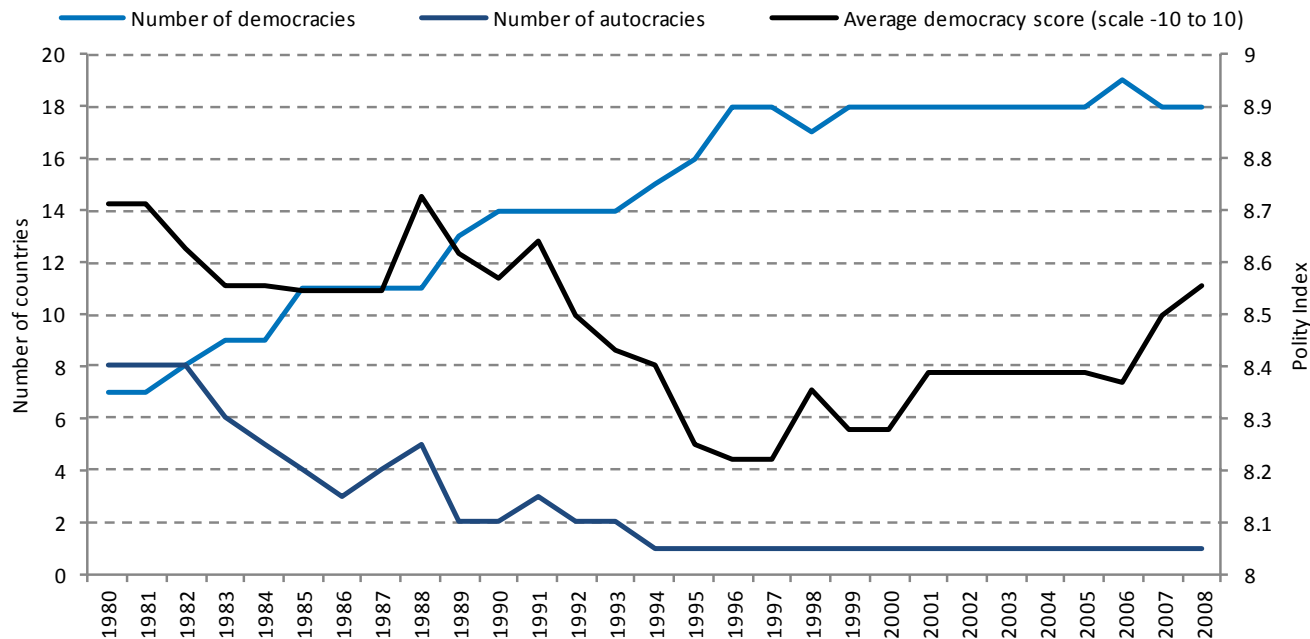
# Democratic transitions, budgeting and public expenditures

## 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



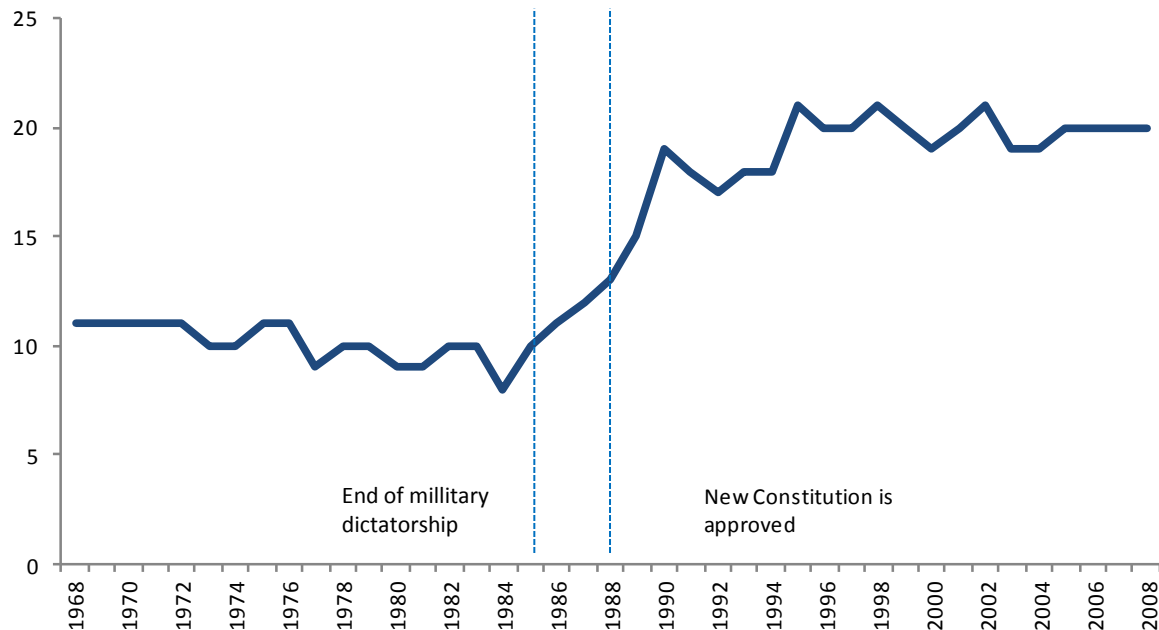
Notes: Following the criteria of Marshall and Cole (2009) countries are classified as a democracy if their Polity score is greater or equal to six

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)

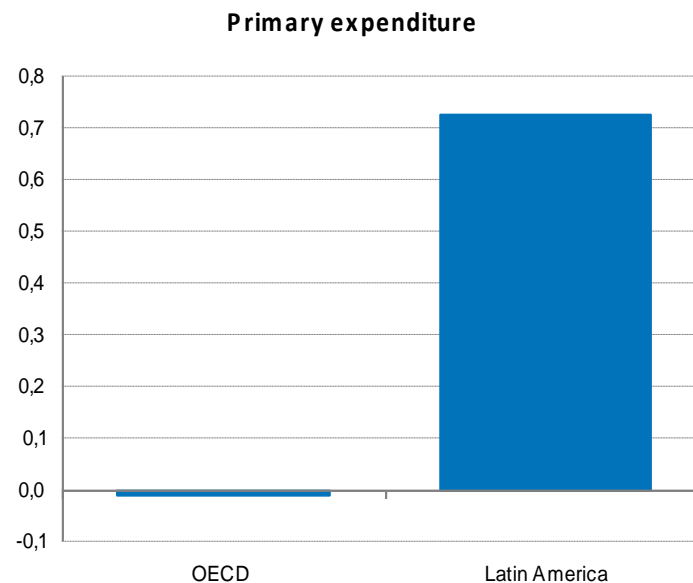
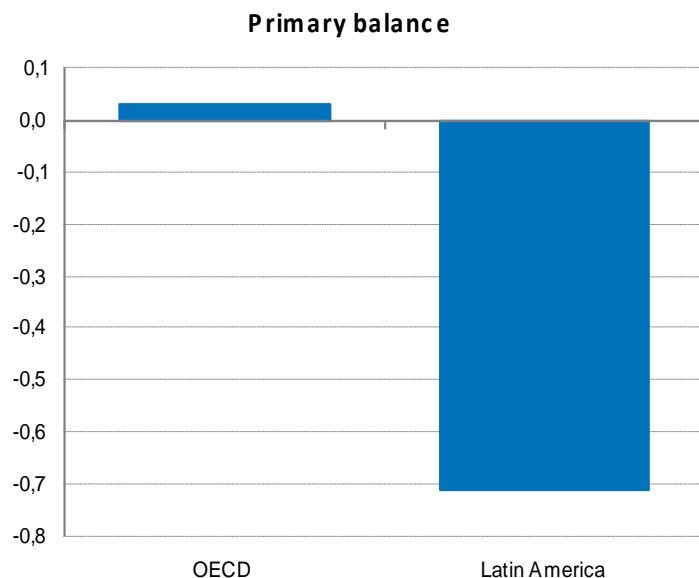


Source: OECD (2010b), based on the World Development Indicators database

**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)



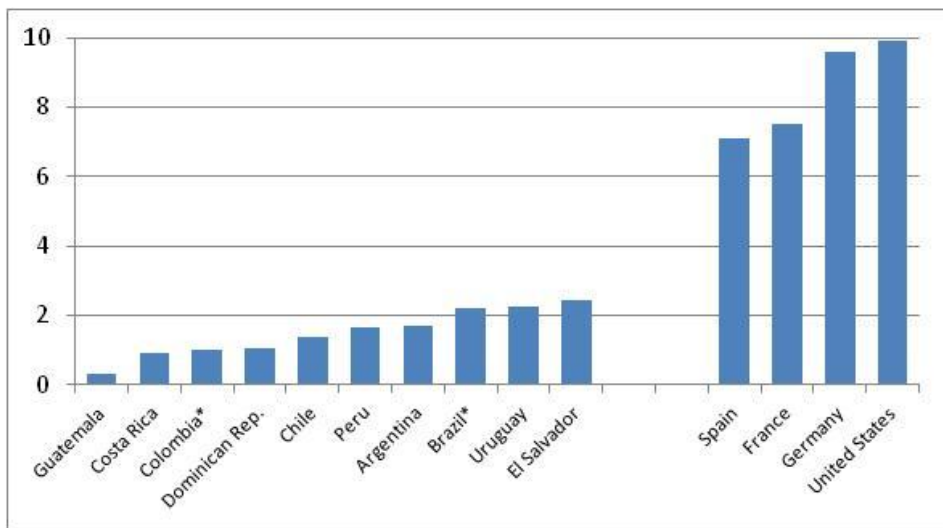
Note: Calculated as the difference between the fiscal variable (as a proportion of GDP) during the election year and prior non-election years

Source: Nieto Parra and Santiso (2009)

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

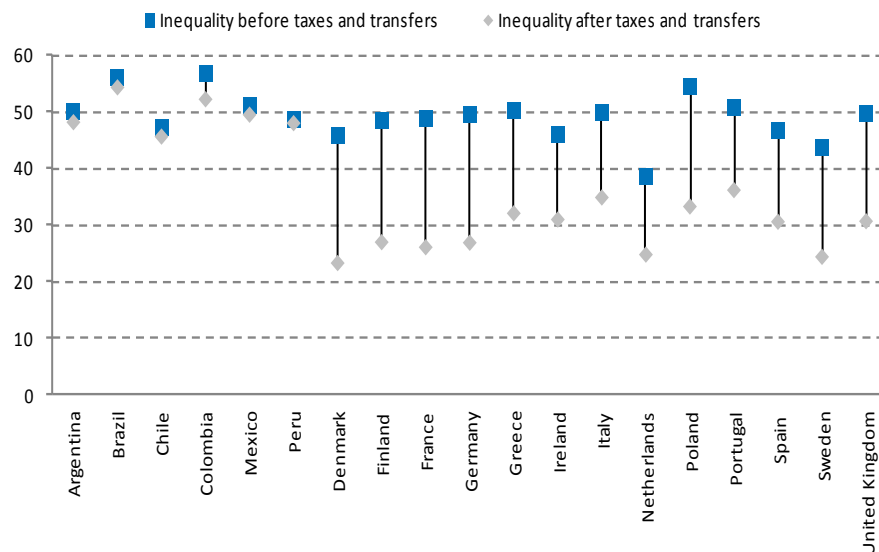
# The challenging political economy of fiscal policy

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)

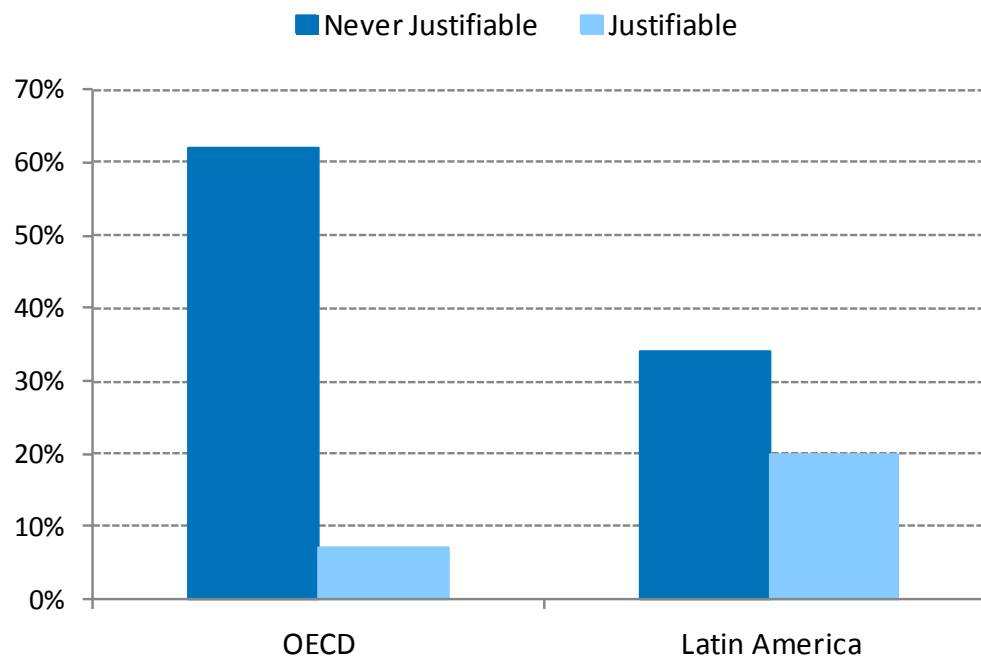


Source: OECD (2011)

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?")

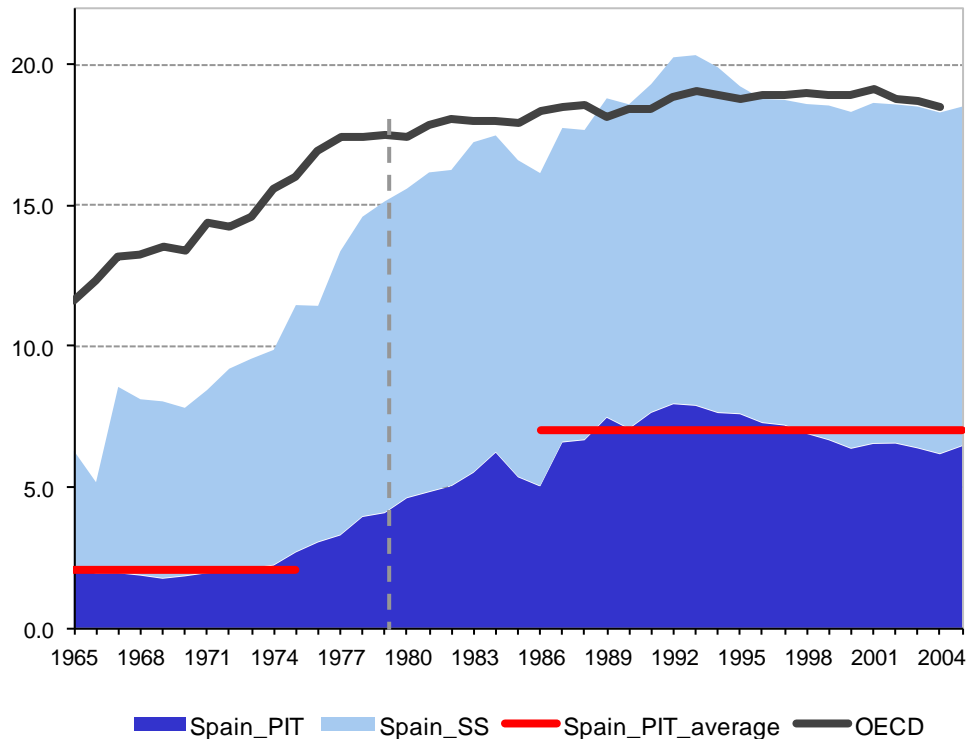


Source: Daude and Melguizo (2010), based on Latinobarometro and World Value Survey

... 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

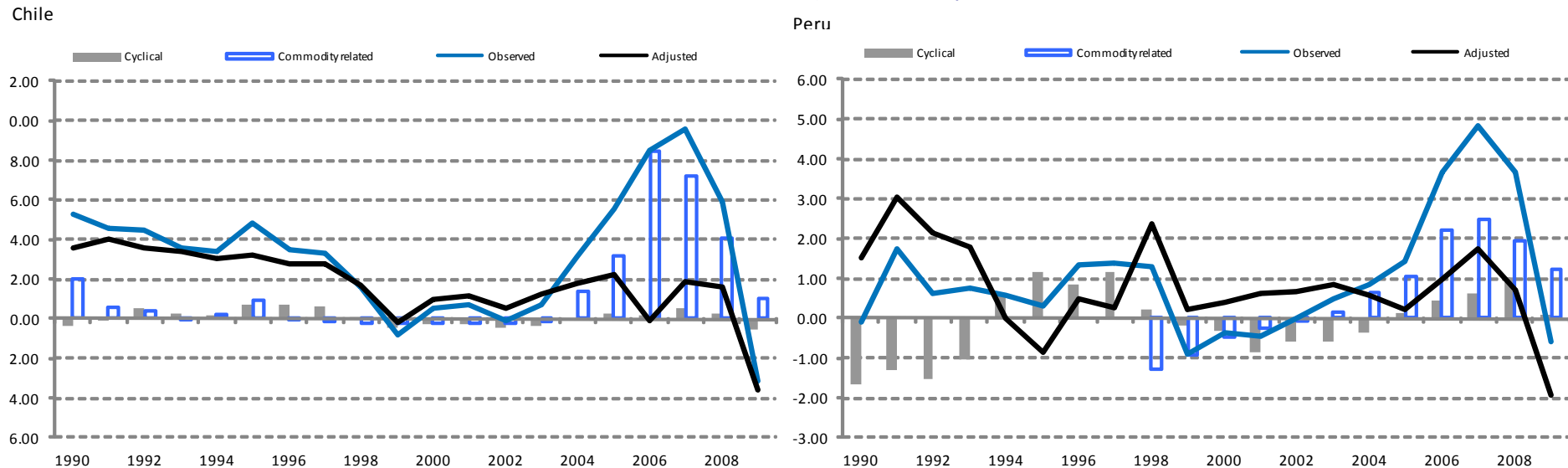
## Some factors making tax reform happen:

- 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)



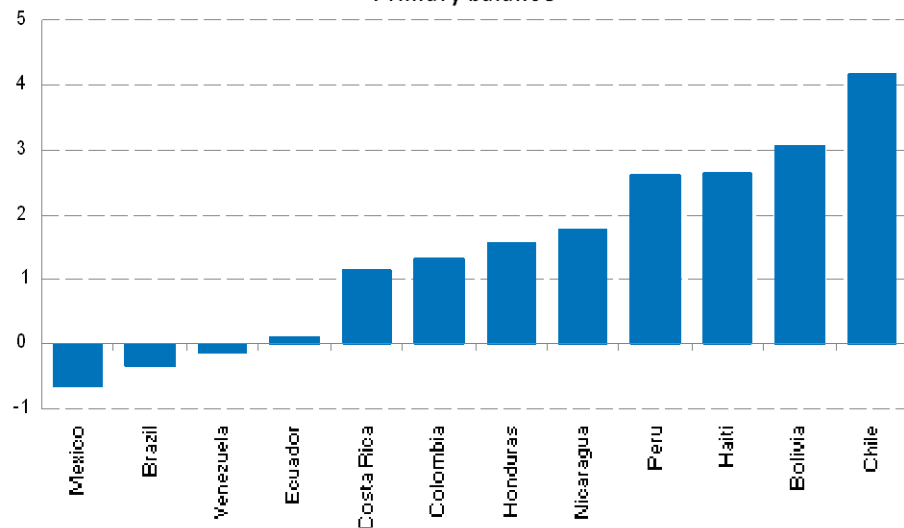
Note: General government primary budget balance is adjusted for deviations of GDP and commodity prices (round their trends)  
Source: Daude et al. (2010)

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

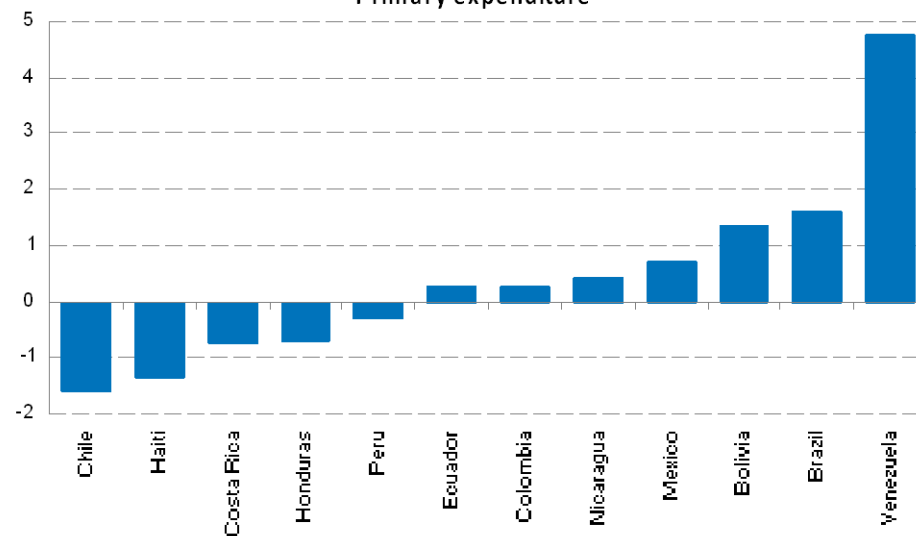
# Good practices in fiscal policy making (*electoral cycles update*)

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

Primary balance



Primary expenditure



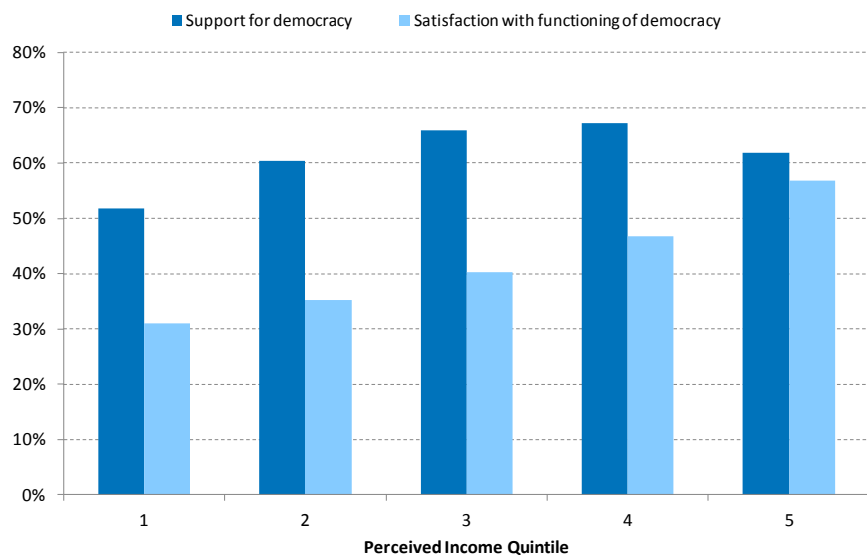
Note: Calculated as the difference between the fiscal variable (as a proportion of GDP) during the election year and prior non-election years

Source: Nieto Parra and Santiso (2009)

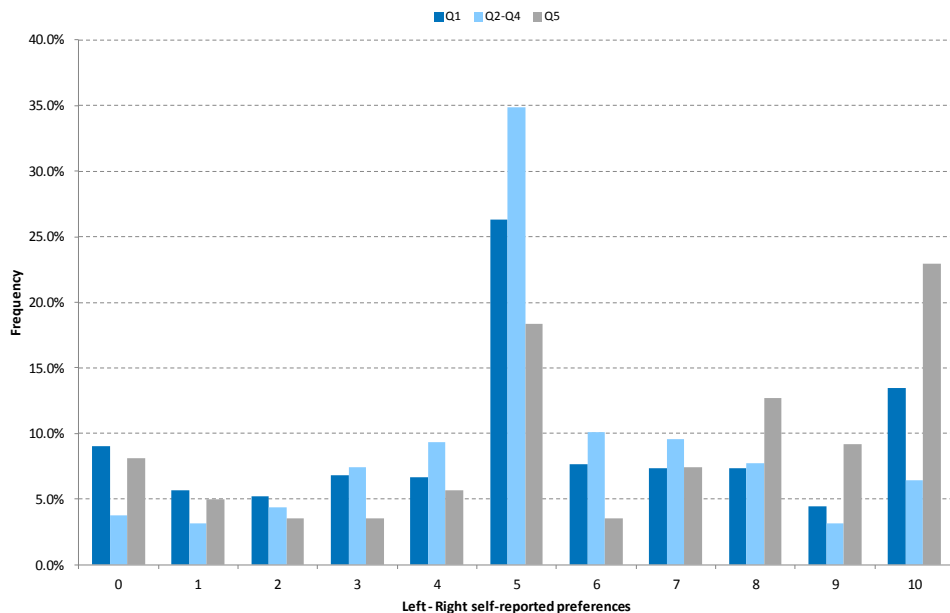
The 2006 round of elections showed significantly a **better performance**

# The emerging middle class and their expectations

## Attitudes towards democracy (% support and satisfaction)



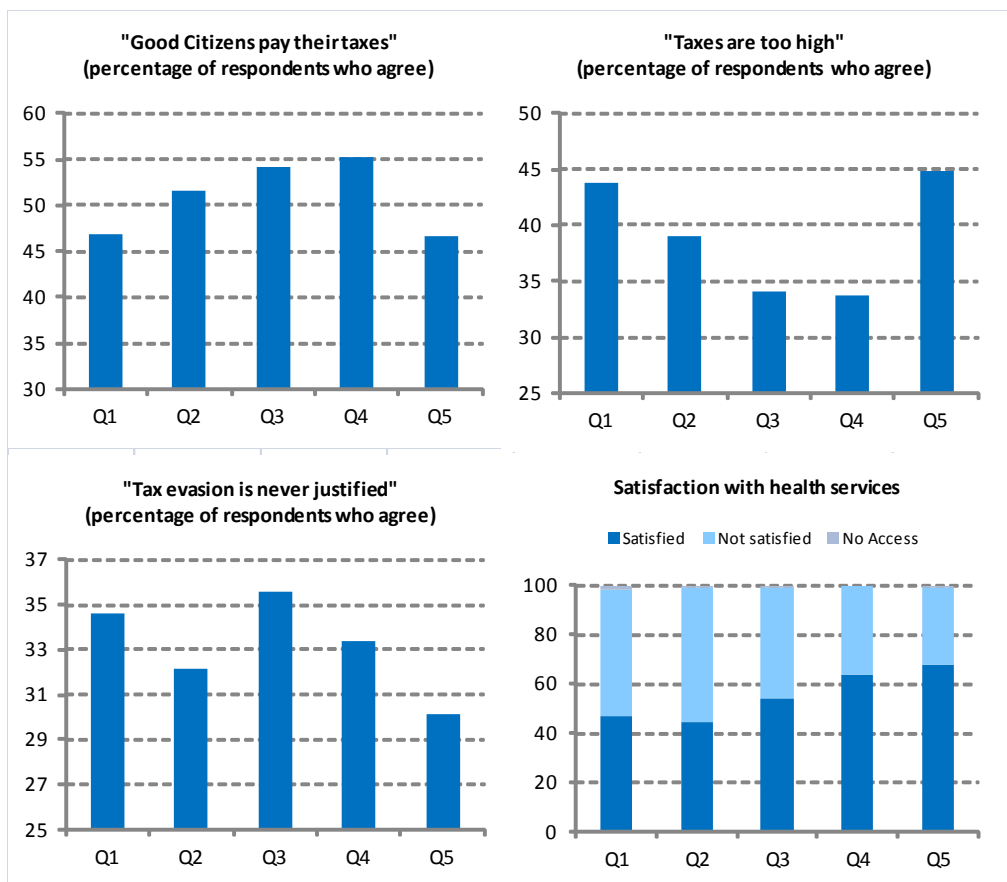
## Distribution of political preferences (0 extreme left, 1 extreme right)



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



Source: OECD (2010b)

## 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**

## 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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## A Latin American perspective

**Choukran jaziran**

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