COMMENTS ON SESSION 4
NATIONAL FISCAL FRAMEWORKS: THE WAY FORWARD

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I want to thank the organizers for giving me the opportunity to share my thoughts on these two interesting papers, in which several relations are established regarding fiscal balances, fiscal rules, and investment in Latin America.

The main link between these two papers has to do with the importance of applying Structural Fiscal Rules (SFRs) in a consistent manner. In particular, the authors emphasize as pre-requisites the following:

- the need to develop sophisticated institutional arrangements;
- gather and maintain comprehensive fiscal information and intertemporal budgeting procedures;
- and, yet, be ready to apply those SFRs with some degree of flexibility in order to accommodate the cycle and the long-term socio-economic targets. In particular, the Carranza *et al.*'s document underscores the target of closing the gap in infrastructure, which explains in an important manner the lagging in growth and gains in total factor productivity in Latin American Countries, especially when compared to Asian countries.

Comments on "Should Latin American Countries Adopt Structural Balance-based Fiscal Rules?" by Teresa Ter-Minassian

Regarding Ter-Minassian's document, I found particularly relevant the following conclusions:

- the crucial role for SFRs in de-coupling phase (2008-10) vs. the re-coupling phase (2011-12). In fact, Latin American countries made excess use of "exit clauses" during the de-coupling phase (4 out of 5 in the large countries) and so did the rest of the world. The IMF reports show that in 50 per cent of the cases where SFRs are used, "exit clauses" were also used. Here my comment to the author is that the reader would benefit if some extensions could be made on how those "exit clauses" were used in the euro zone during the pre-brake of the Maastricht treaty;
- she makes a good case for the use of simple and realistic rules rather stating a "hard" SFRs which later would have to be modified or eluded all together. This false sensation of fiscal discipline through "hard" SFRs does not yield much in the long run. She also provides several examples on how sticking (unrealistically) to "hard" SFRs might hinder other fiscal responses at hand. My comment in this regard is that the profession could extract several useful lessons from the application of the "Inflation Targeting" (IT) strategy in Latin America. I personally understand IT as a "hard-rule" for the long-term, but one that permits flexible and discretionary application in the short-term (including the use of "exit clauses". Furthermore, IT has now evolved into a "comprehensive IT", incorporating many lessons on how the financial bubbles might jeopardize a simplistic IT view, focusing only in the control of goods-and-services inflation (CPI or WSP).

I found interesting and constructive her discussion on how to make more flexible the SFRs. In particular, she recommends:

- adding fiscal watchdogs (not simply committees of experts, like in Chile);

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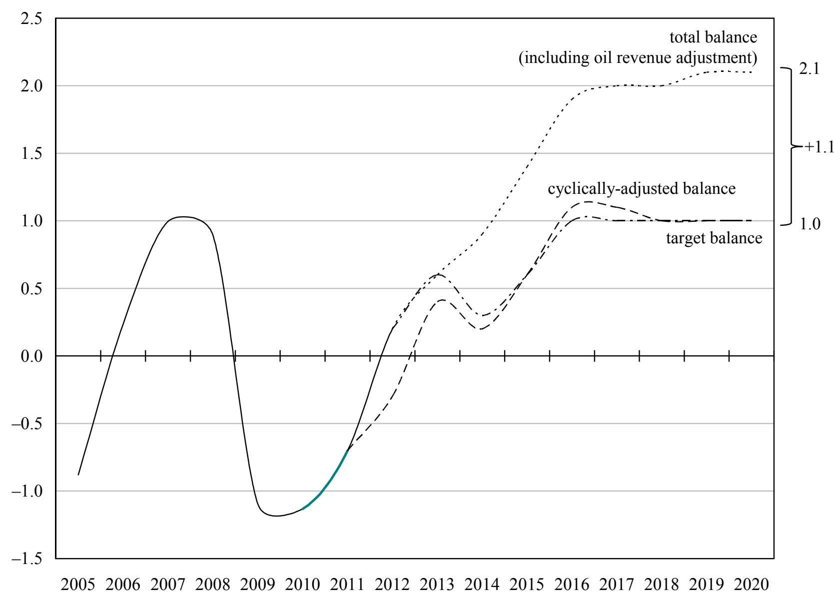
- distinguishing temporary from permanent shocks;
- introducing fiscal-range target, instead of point targets.

Figure 1

Colombia: Decomposition of Required Primary Balance

(percent of GDP)



Source: Confis-DGPM, Ministerio de Hacienda y Crédito Público (MHCP).

The thrust of the paper of Ter-Minassian's goes into discussing the taxonomy of SFRs and its determinants. Regarding the "production gap", she analyses current vs. potential growth. Here, there are several possibilities, namely, cyclically-adjusted balance, growth base balance, base-line over the cycle. All of them reveal the problems of estimating the output gap. Regarding the "fiscal target", the menu includes: i) the primary balance (the favorite choice), but there are problem of creative accounting when considering the effect of quasi-fiscal deficits; ii) the current expenditure balance, which could allow for infrastructure expenditure, but others could argue instead in favor of opening room for human capital; and iii) the overall balance, but this approach phases the problems arising from sub-nationals deficits, which are quite important in the cases of Brazil, Argentina, and Colombia.

Recent experiences worldwide pinpoint to the use of SFRs focused on:

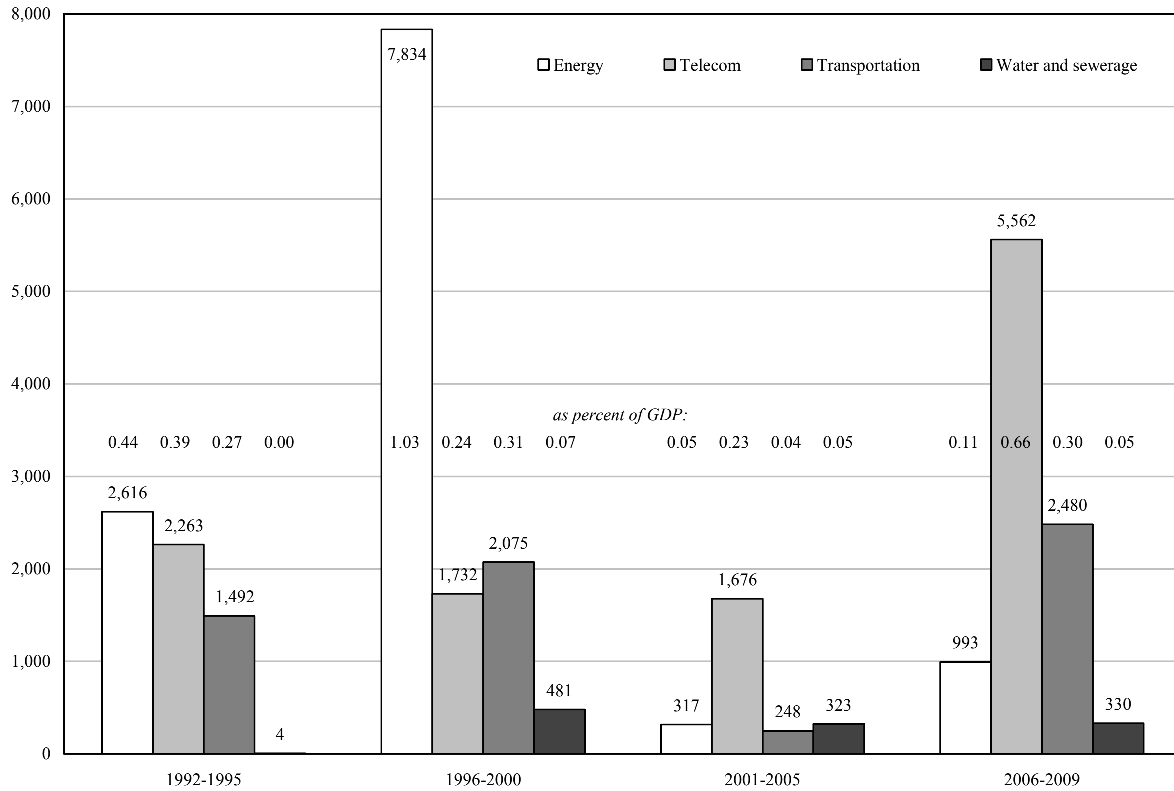
- cyclically-absorption-adjusted balance, which is the main proposal within the OECD countries;
- cyclically-revenue-adjusted, which is now in fashion in Latin American countries, where Colombia is in the process of enacting a rule under this approach.

Finally, Ter-Minassian's paper goes into the discussion of macro long-term targets. Here the alternatives include: growth path, public debt path, and needs regarding infrastructure and savings. All these theoretical discussions are well anchored in first hand experiences, when she was on the staff of the IMF and now as a consultant; particularly those regarding Chile (now a consolidated process), Brazil (in adjusting mode), and Colombia (a nascent case).

My last recommendation for Teresa is that all these experiences could be better understood if graph Illustrations could be added showing the problems of "credibility" arising from the recurrent application of exit clauses. For instance, in the future we should be discussing why was it that the Colombia authorities deviated from the current projections, which I here show in Figure 1. This is not an easy task since one would require detailed "real time" data to be able to make comparisons with the effective paths followed by those countries, but I reckon that (by now) she has an excellent fiscal network that would allow her to pursue this approach (… if not her, who?).

Figure 2

Colombia: Private Investment in Infrastructure
(USD mm of 2010)



Comments on "Public Infrastructure Investment and Fiscal Sustainability in Latin America: Oxymorons or Compatible Goals?" by Luis Carranza, Christian Daude and Ángel Melguizo

Regarding Carranza, Daude and Melguizo's paper, I would like to pinpoint the following conclusions:

- fiscal rules should help in opening space for fixed-capital-investment (FKI), which is lagging in Latin American countries vs. Asia or Eastern Europe;
- counter-cyclical policies helped during decoupling, by adding expenditures between 0.6-3 per cent of GDP in Latin American countries. Out of this additional expenditure, about ½-1/3 was devoted to infrastructure, especially in the case of Peru;
- to unravel fiscal stimulus without retrenching from FKI requires: 1) timing; 2) analysis of expenditure size; 3) work on both fronts revenue and expenditure.

Here my comments to the authors go in the line of emphasizing the role for:

a) solutions that look for solidification of public-private partnerships; and
b) making sure that capital markets are a big part of the solution in supporting additional infrastructure through project financing, toll securitizations, and sovereign fund monies (following the examples of Chile and India). In Figure 2, I illustrate how private investment played a crucial role in the cases of energy and telecom in the case of Colombia, so more

examples in this direction could help the reader understand this expected role of capital markets in Latin America.

The authors present interesting trends of the infrastructure in Latin American countries. This is a significant contribution in region that lacks good historical information in this area. The authors, in my view, are to be praised for their effort in filling this gap. They cast a crucial question: do fiscal adjustments in Latin American countries have implied sacrifices in terms of FKI? Their answer is a yes. For instance, during 1980-90 the ratio FKI/GDP was 2.5 per cent, while the fiscal deficit/GDP ratio averaged 4 per cent, but during the 1991-2006 period these values were 1 per cent for the investment ratio and –2 per cent for the fiscal deficit.

One issue very relevant for the current juncture in Latin America is the discussion of how to open space for FKI in the presence of fiscal rules. The authors discuss the cases of Petrobras (Brazil) and Ecopetrol (Colombia). In fact, both companies now received treatments as private capitals, while the government has taken a more passive view regarding long-term business strategy, while receiving their annual profits as main owners of those firms.

One suggestion for the authors is to make more explicit how SFRs should take into account short-run needs; as they spell it out in the case of the long-term needs (obviously, infrastructure). They recommend assets & liability management and make a constructive discussion regarding "golden rules", excluding FKI.

Finally, the authors make an interesting discussion on how SFRs evolved in the case of Peru. During the period 2000-06, they discuss the use of "exit clauses" and how the sub-national component was included (coinciding with the point made by Ter-Minassian). They close the paper by illustrating the inclusion of the FKI component during the recent years of 2009-10.