



INTERGOVERNMENTAL FISCAL RELATIONS IN LATIN AMERICA: REGIONAL DISPARITIES AND FISCAL SUSTAINABILITY

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**Economic Commission for Latin America
and the Caribbean (ECLAC)**



UNITED NATIONS

ECLAC

**IPD Decentralization TF Meeting
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AGENDA

- Introduction
- Structural Characteristics of the Region
 - Inequality of income distribution
 - Regional inequality within the country
 - High urbanization and informality
 - Institutional heterogeneity
- Basic features of fiscal policy: problems of solvency and volatility
- The process of reallocation of functions
- Financing decentralized expenditures: subnational tax revenues
- The role of central government and coordination mechanisms
- Final remarks and future challenges



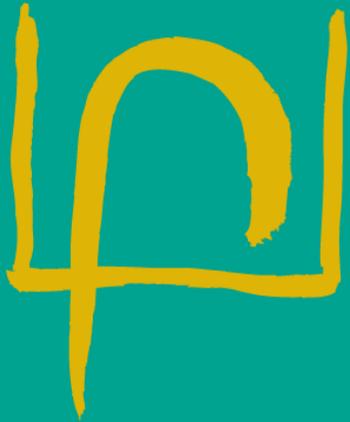
Introduction

- Basic question
 - Institutional, economic, and social characteristics have strongly influenced both the design and the results of decentralization processes
 - Central government have to coordinate:
 - To maintain macro fiscal sustainability
 - To compensate for regional and personal disparities
 - To articulate decentralized sectorial policies



Introduction

- Basic features of macro fiscal policy have limited the capability of central government to fulfill these three objectives
- Recent experiences in the region shows the difficulties of central government balancing these objectives.
- The lack of intergovernmental coordination led to instances in which one of the three aspects would dominate the others

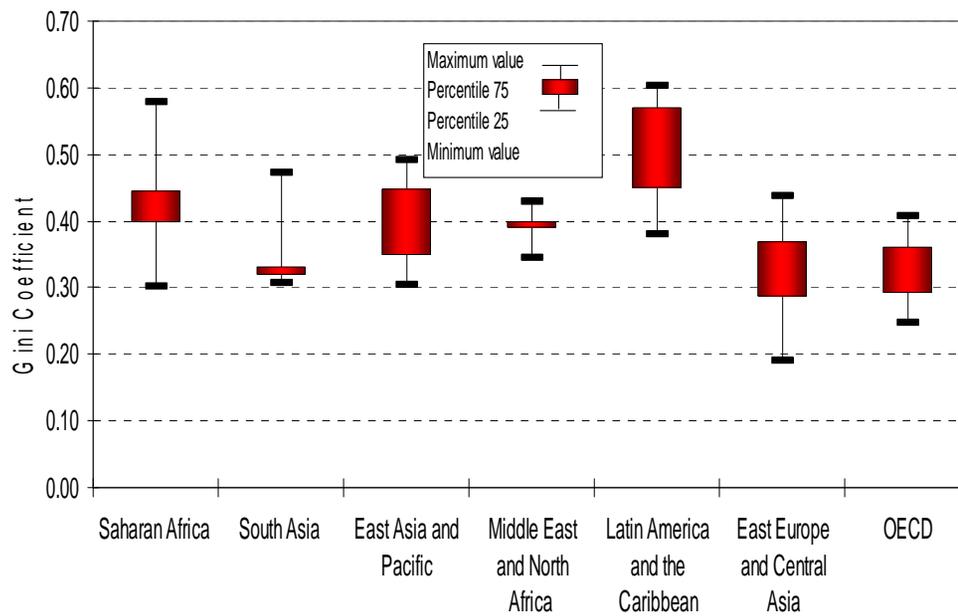


1. Structural characteristics of the region

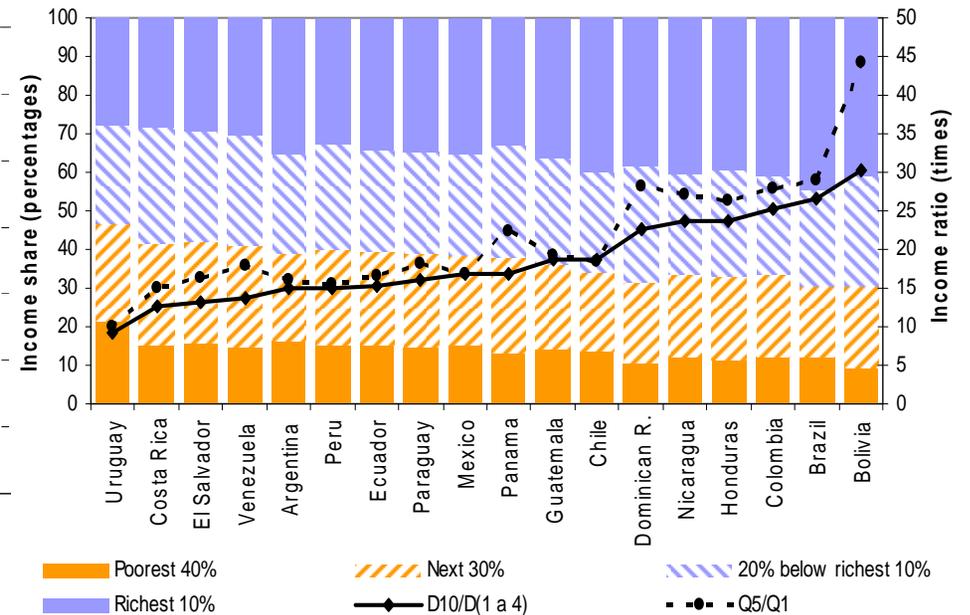
Despite heterogeneity between countries, there is a group of common structural characteristics. We want to highlight that these common features create serious challenges for public sectors trying to adequately provide and coordinate goods and services.

Inequality of income distribution

Gini coefficients for groups of countries



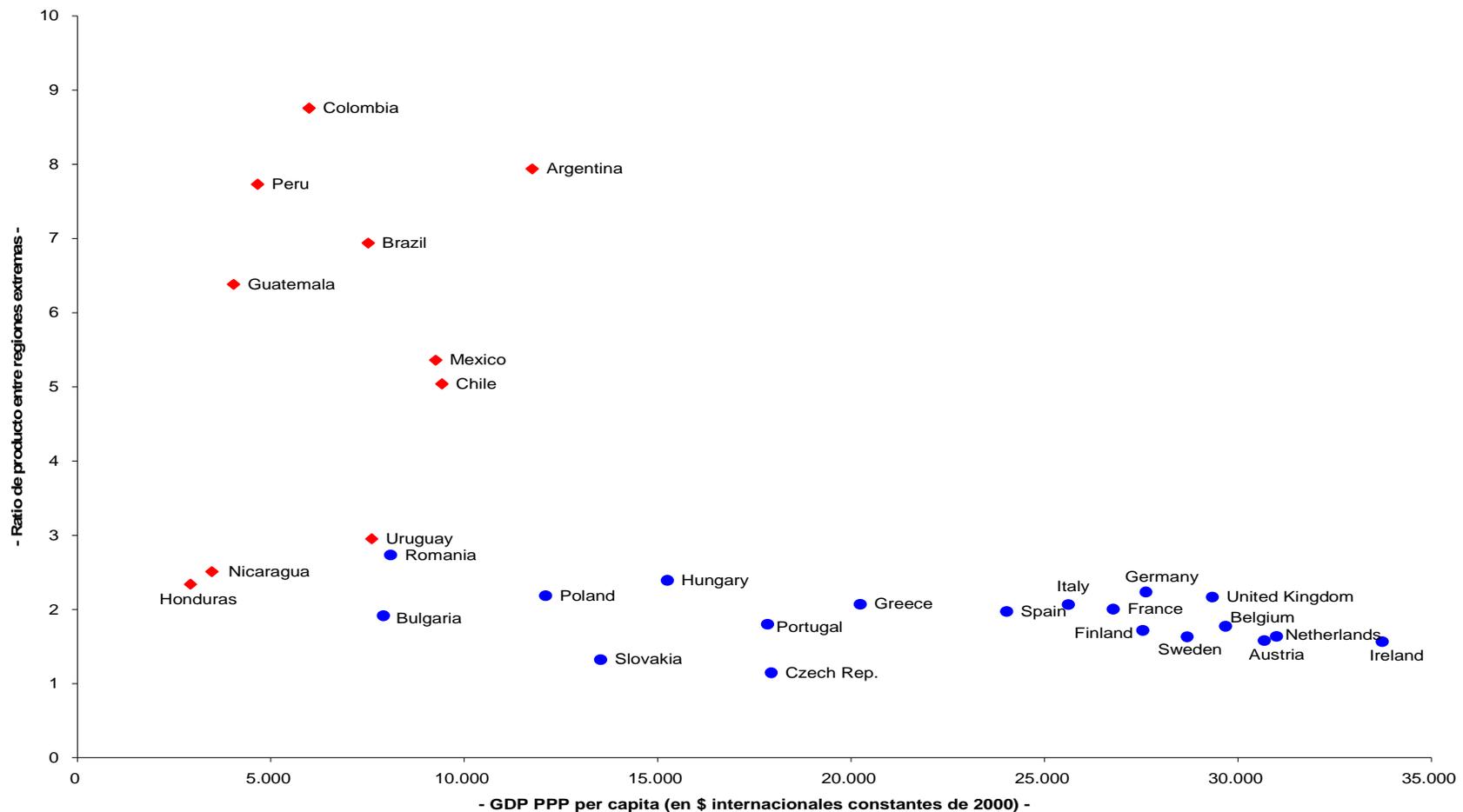
Structure of income distribution by deciles



Source: ECLAC on the basis of World Bank, World Development Indicators 2007.

Regional inequality within the country

Comparison of the per capita GDP between the highest and lowest income jurisdictions in Latin American and Caribbean countries and European Countries



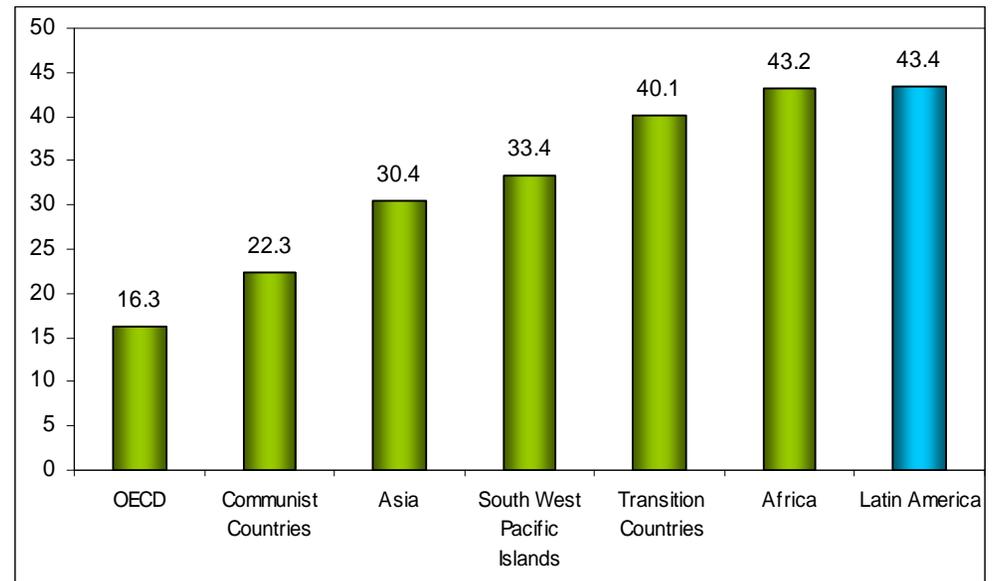
High urbanization and informality

URBAN POPULATION, 2003
(Percentage of total population)

Region	% of Urban Population
Latin America and the Caribbean	77
Caribbean	64
Central America	69
South America	81
North America	80
Europe	73
Oceania	73
Arab States	55
Africa	39
Asia	39

Source: UN Population Fund

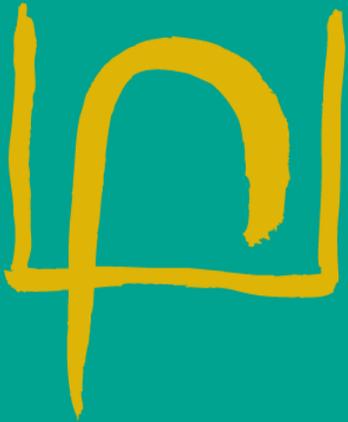
The informal economy in the world -
Average 2002/2003



Source: own based on Schneider (2006)

High institutional heterogeneity

- Federal and unitary countries
- Federal: Argentina, Brazil, Mexico and Venezuela
- Unitary: The remaining cases can be differentiated from more traditional unitary organization like Uruguay, or cases such as Colombia which is a decentralized unitary republic, with territorial autonomy.



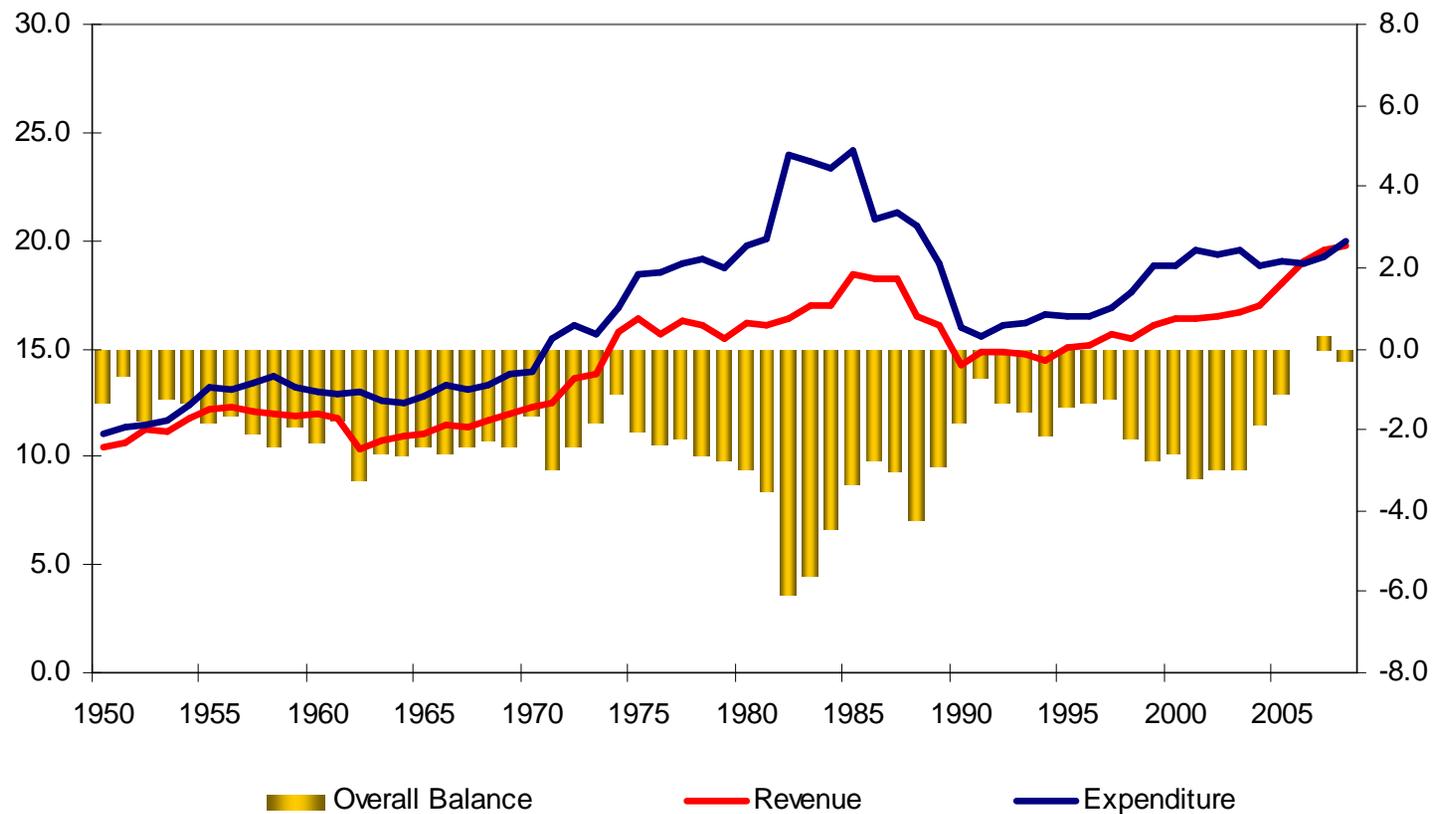
2. Basic features of fiscal policy: problems of solvency and volatility

Policies such as those related to income redistribution, territorial compensation, and inclusion of the informal sector are very demanding of public resources. The problem is that several times these policies have reached the limit of the lack of fiscal solvency of the public sectors in Latin America.

Basic features of fiscal policy: problems of solvency and volatility

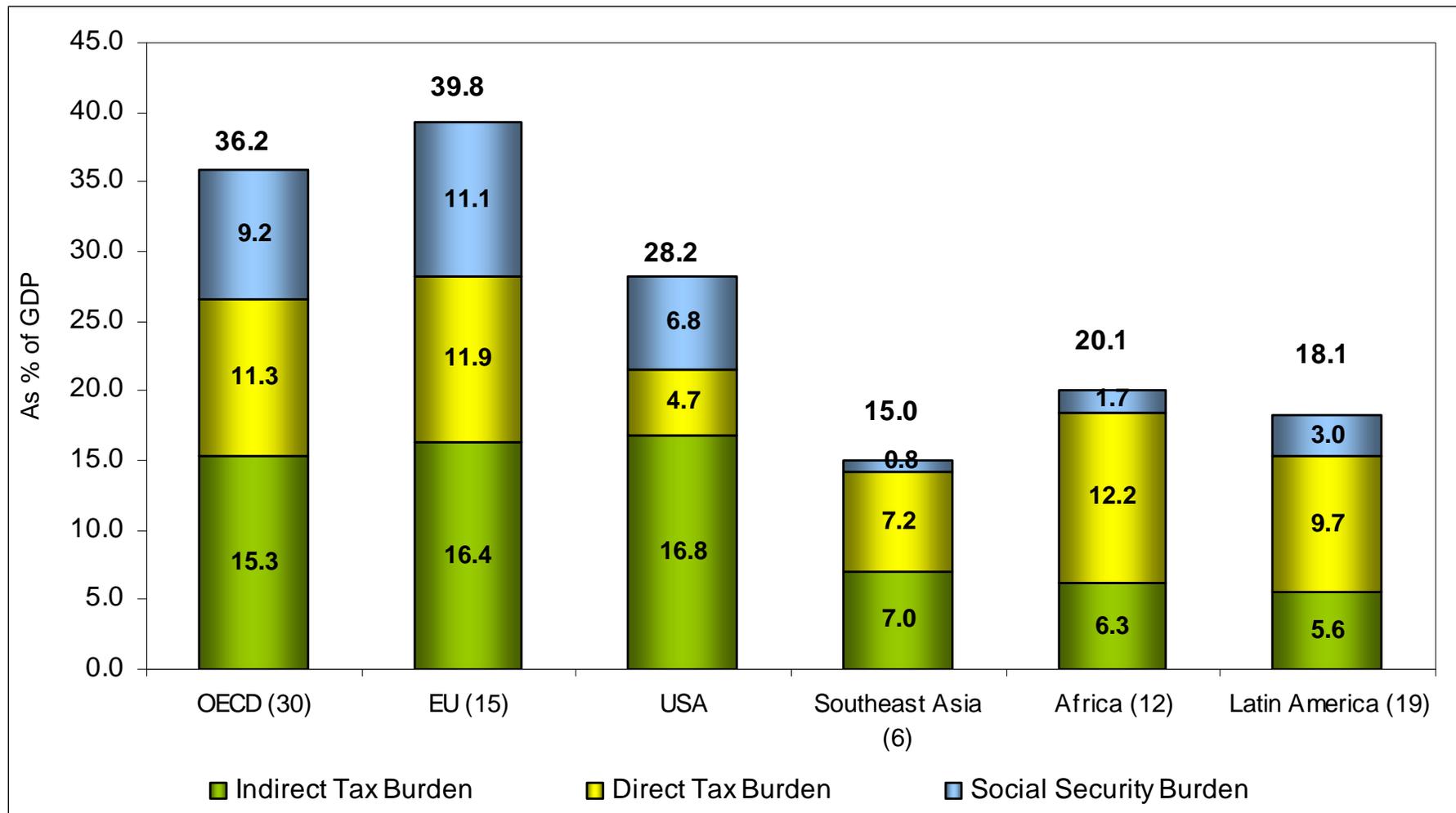
Historically Latin America has registered fiscal deficit accounts

LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT REVENUE, EXPENDITURE AND OVERALL BALANCE
(Simple Average, as a percentage of GDP) 1950-2008



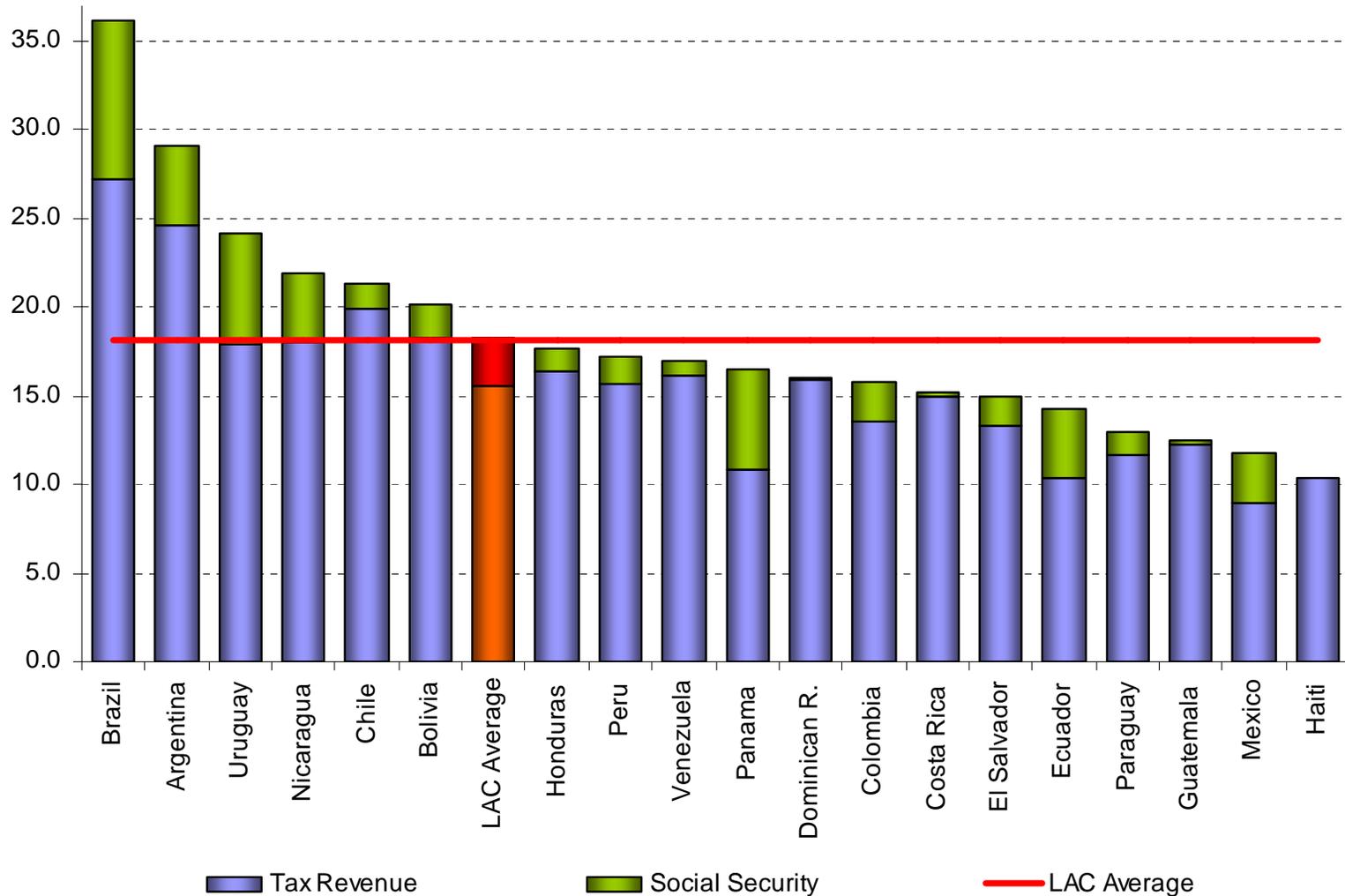
Low tax burden and based on indirect taxes...

TAX STRUCTURE COMPARED BETWEEN REGIONS
(As a percentage of GDP)

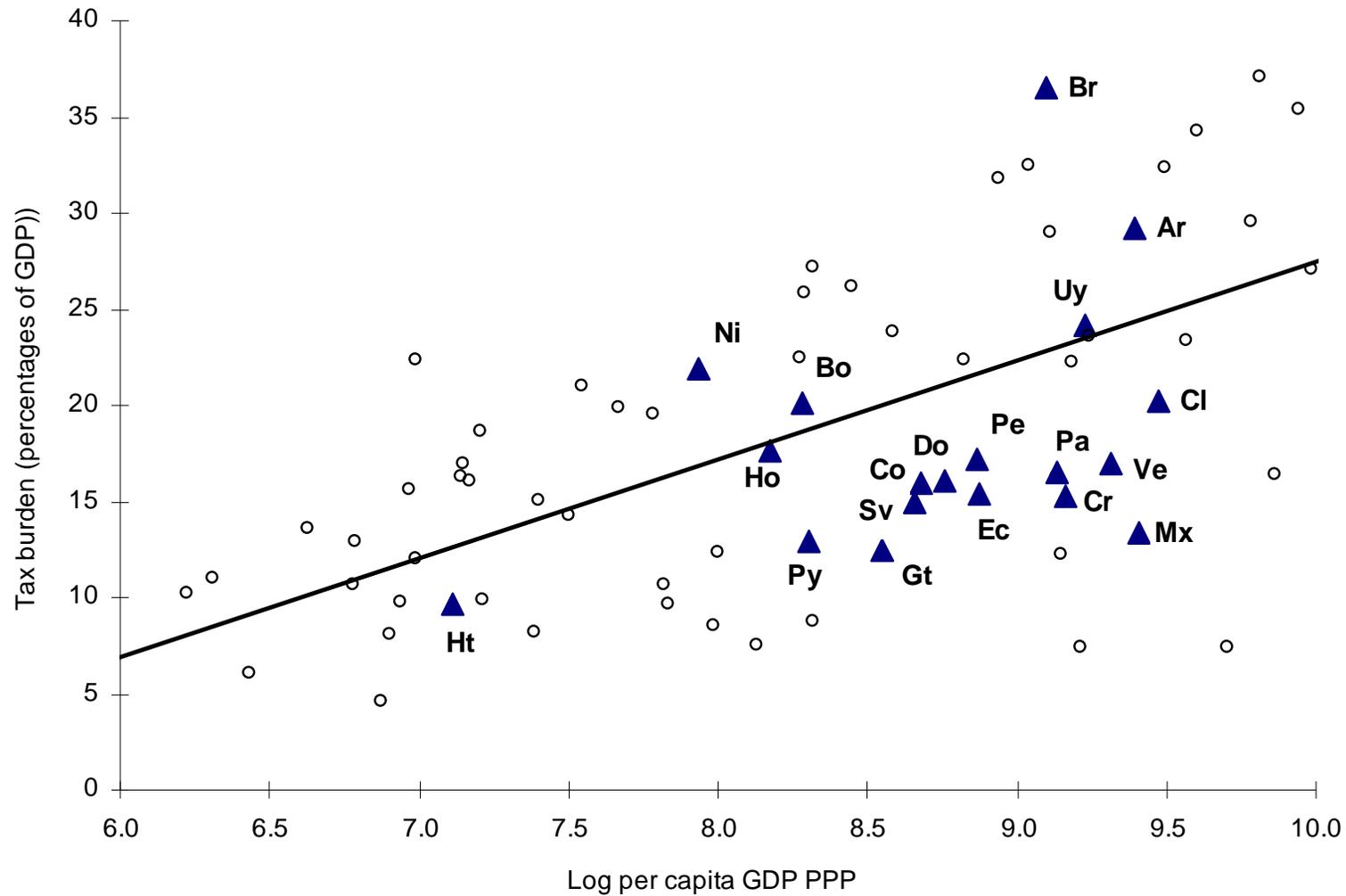


...with heterogeneous tax effort

Tax Burden by Country



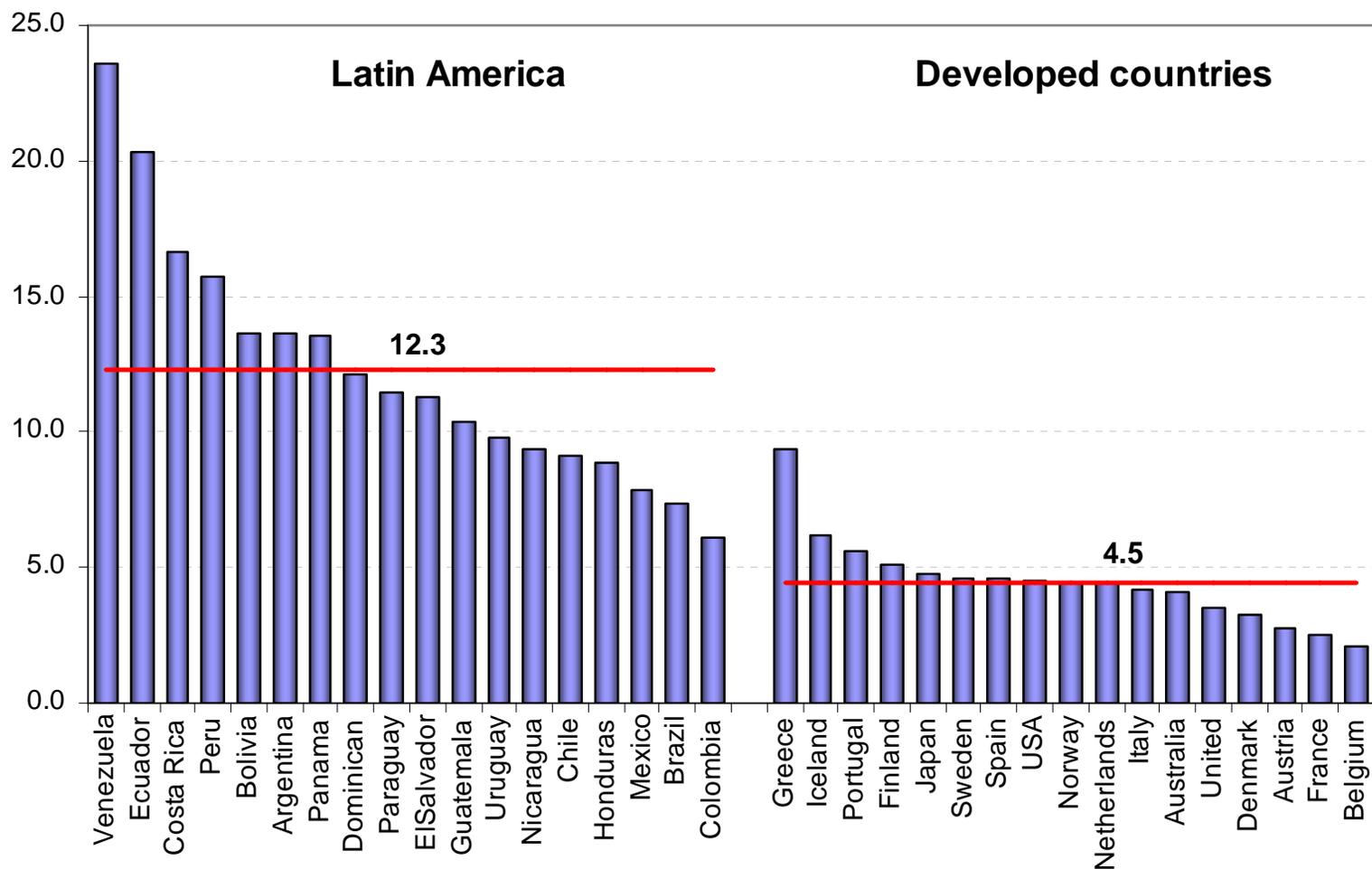
Tax Burden and per capita GDP (PPP, USD)



Source: Jiménez and Podestá (2008) on the basis of ECLAC, OCDE and WDI, World Bank

High volatility of tax revenue

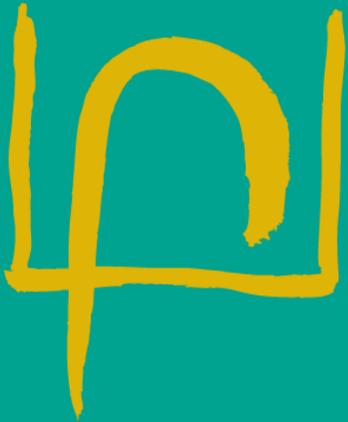
LATIN AMERICA AND DEVELOPED COUNTRIES: VOLATILITY OF TAX REVENUE
(Standard Deviation)



Source: R. López Monti (2009)

Latin America and the Caribbean: Countries dependent on exports of commodities, 2007

Commodity	Over 50% of total exports	Between 20% and 49% of total exports	Between 10% and 19% of total exports
<i>Energy goods</i>			
Crude oil and oil products	Venezuela (92.55), 2006 Ecuador (59.26)	Barbados (31.18) 2006 Colombia (26.77), 2006 Santa Lucia (21.62), 2006 Trinidad and Tobago (42.32), 2006	Argentina (11.09), 2006 Bahamas (18.33), 2006 Belice (16.17), 2006 Mexico (15.54) Jamaica (14.69)
Natural gas		Bolivia (Plurin. St. of) (40.75), 2006 Trinidad and Tobago (34.15), 2006	
<i>Mineral goods</i>			
Coal			Colombia (11.08)
Copper	Chile (56.90)	Peru (36.12)	
Gold			Peru (14.87)*
Zinc			Bolivia (13.39), 2006
<i>Agricultural goods</i>			
Coffee		Honduras (20.91)	Nicaragua (17.25)
Bananas		Dominica (21.27) 2006 Saint Vincent and the Grenadines (29.29), 2006	Panama (10.12) Santa Lucia (18.95), 2006
Soya		Paraguay (30.22), 2006	Argentina (13.55), 2006
Suger			Belice (18.23), 2006
Rice			Saint Vincent and the Grenadines (9.88), 2006
<i>Crustaceans and molluscs</i>			
			Bahamas (18.26), 2006 Belice (15.45), 2006 Panama (10.18)
<i>Beef (cattle and meat)</i>			
			Nicaragua (12.06) Paraguay (21.49), 2006



3. The process of reallocation of functions between levels of government

Over the past few decades, various reforms to the organization of public policies have been discussed and implemented. Reforms such as the decentralization of the process of provisioning goods and services should be understood as part of this wave of reforms. These trends have been quite widespread, covering both unitary and federal types of political organization.

Reallocation of functions: motivations

- Processes during non democratic governments
 - Sectorial reform (Chile)
 - Fiscal motivations of the central government (Argentina)
 - Democracy promotion, reducing central government power (Brazil)
- Political reforms in democracy (Bolivia, Colombia, Ecuador, Peru)



Reallocations of functions: Sectorial perspective

- Education
- Health

The process of reallocation of functions

Expenditures of Subnational Governments (As percentages of GDP)

	1985-1990	1991-1995	1996-2000	2001-2007
ARGENTINA	8.7	11.0	11.9	12.5
BOLIVIA	2.8	5.7	7.0	8.9
BRAZIL	14.4	17.3	13.9	12.9
CHILE	2.3	2.3	3.0	2.9
COLOMBIA*	5.2	5.0	7.3	8.0
COSTA RICA	0.8	0.6	0.7	0.8
ECUADOR	...	1.8	2.2	3.8
MEXICO**	3.7	4.0	5.5	7.2
PARAGUAY	0.4	0.3	0.3	0.4
PERU	...	1.8	2.0	2.3

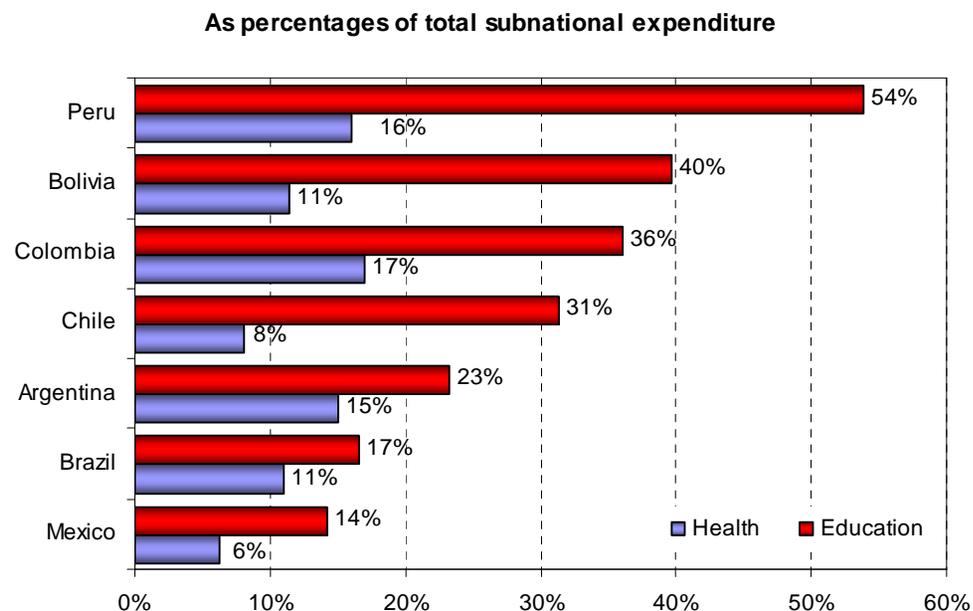
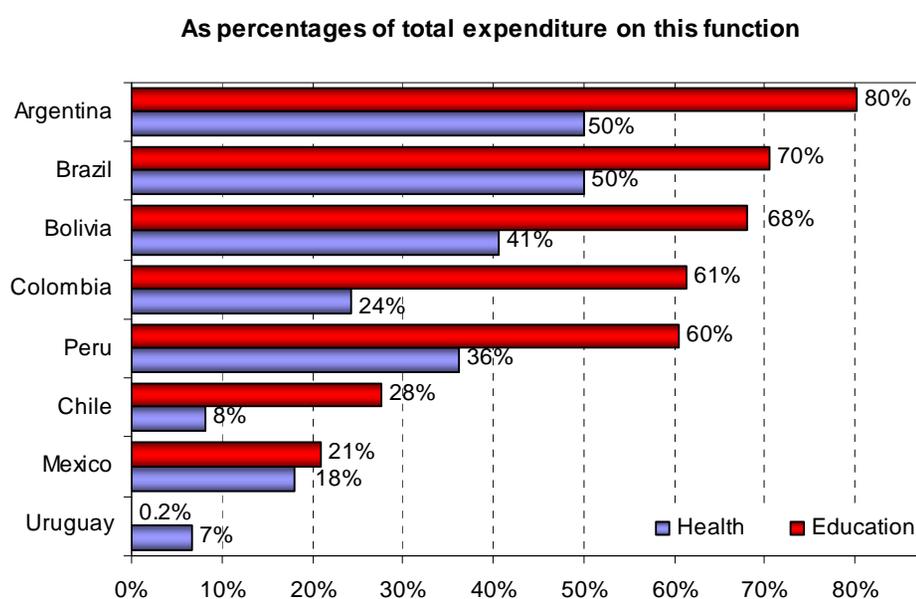
* Average 1985-1990 belongs to 1986-1990

** Average 2001-2007 belongs to 2001-2006

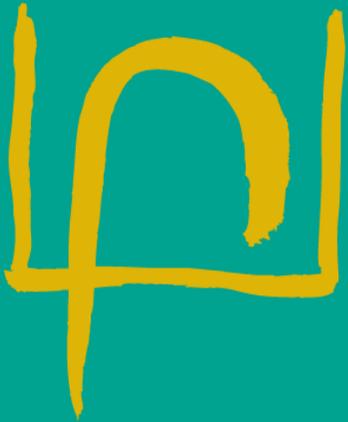
Source: ECLAC

The process of reallocation of functions

Health and Education Expenditures of Subnational Governments (As percentages of total expenditure on this function and as percentages of total subnational expenditure)



Source: ECLAC

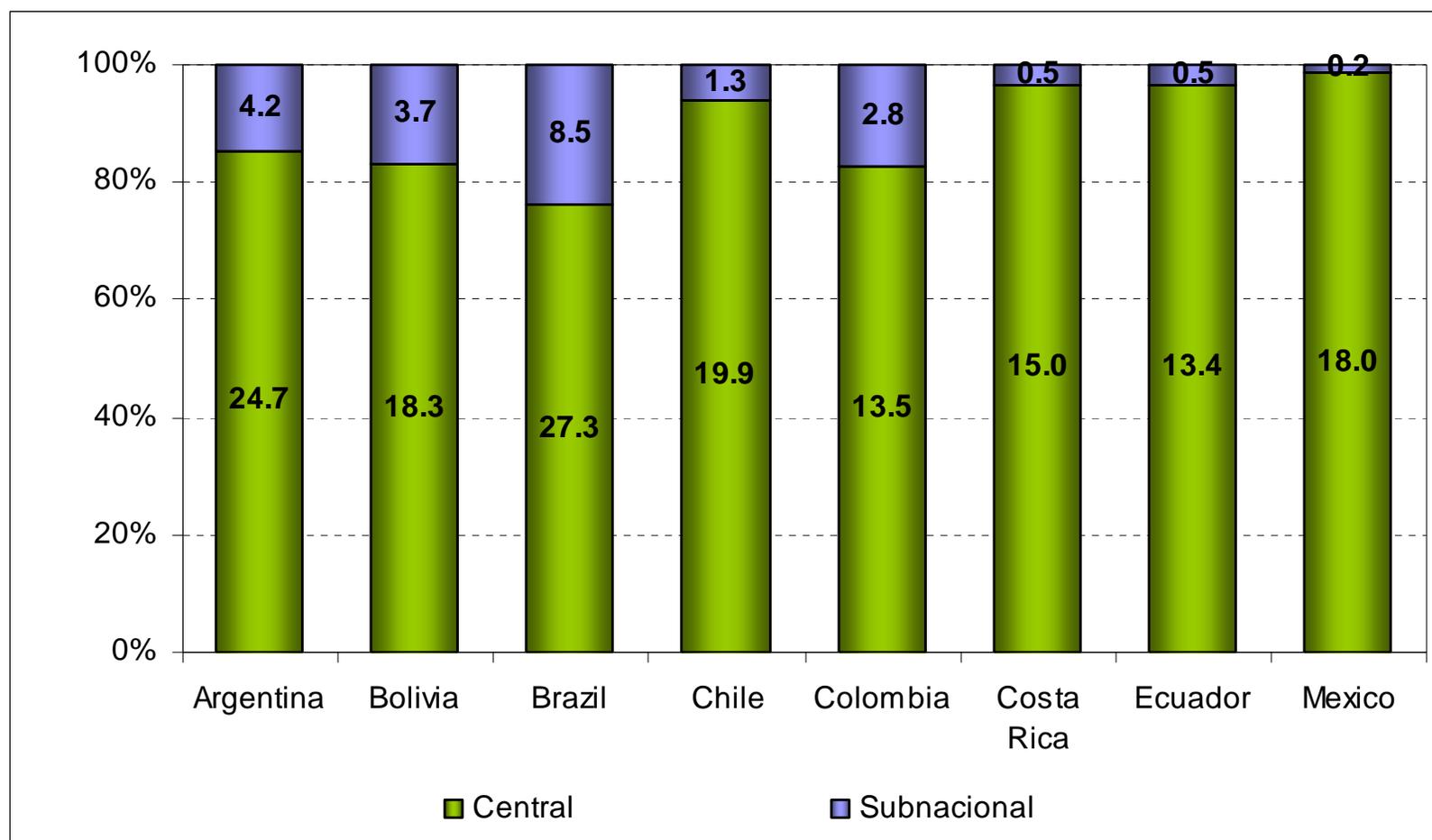


4. Financing decentralized expenditures: subnational tax revenues

A distinctive feature of the region is the serious problem the public sectors has financing its various activities. This restriction has affected all of the activities of the region's governments, and has important consequences on the final impact of decentralized public policies.

Allocation of fiscal revenue

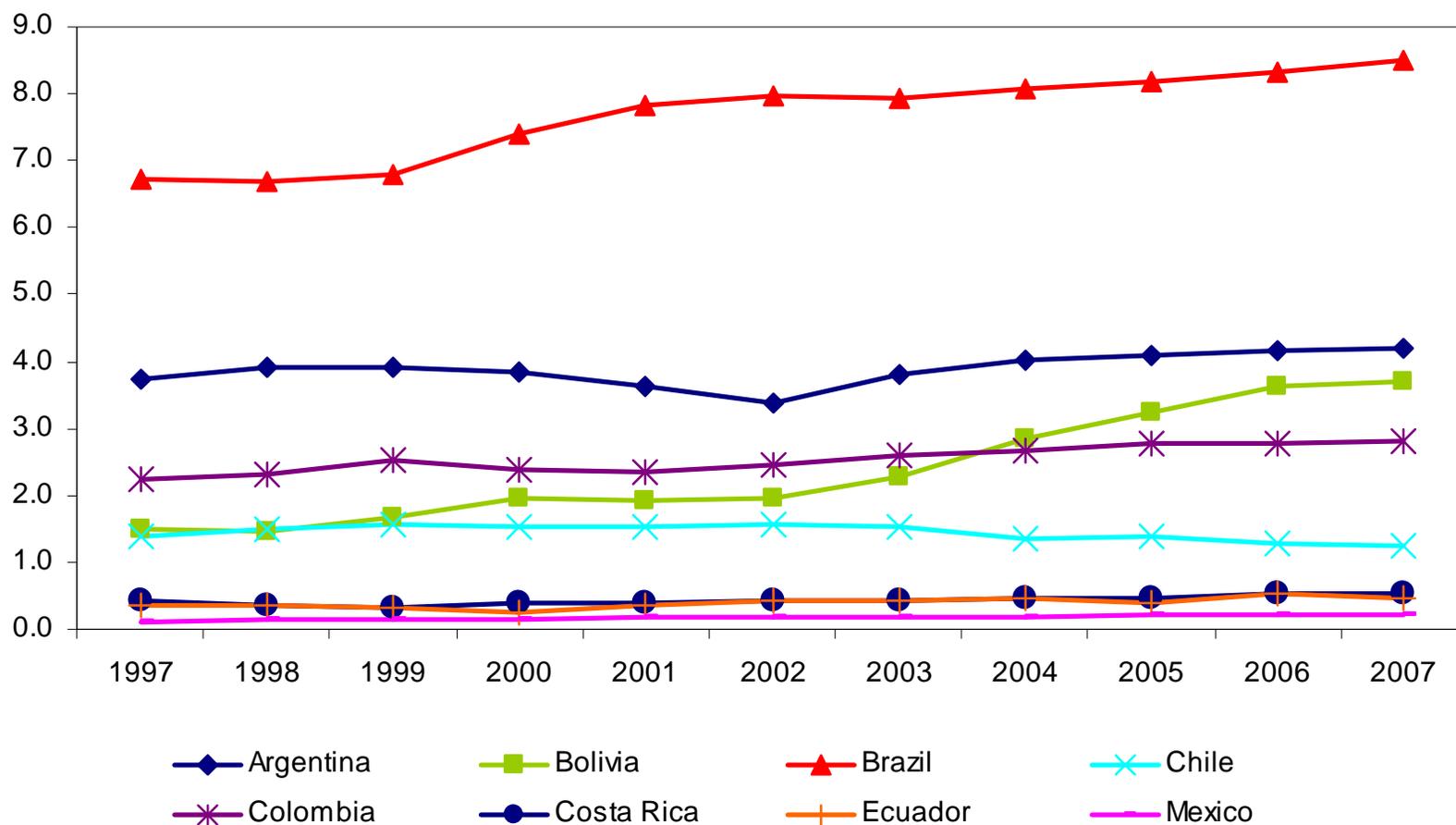
Structure of tax revenues by level of government *As percentages and percentage of total GDP*



Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on official figures.

Allocation of fiscal revenue

Revenue Tax of subnational governments - *Percentage of GDP*



Source: ECLAC

The property tax in representative groups of countries and in Latin America (Percentages of GDP)

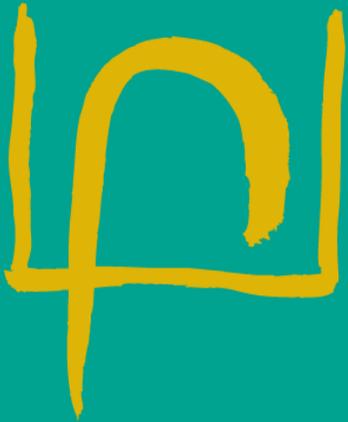
	1970s	1980s	1990s	2000s*
All countries	0.77	0.73	0.75	1.04
(number of countries)	(37)	(49)	(59)	(65)
OECD countries	1.24	1.31	1.44	2.12
(number of countries)	(16)	(18)	(16)	(18)
Transition countries	0.34	0.59	0.54	0.68
(number of countries)	(1)	(4)	(20)	(18)
Developing countries	0.42	0.36	0.42	0.6
(number of countries)	(20)	(27)	(23)	(29)
Latin American countries	...	...	0.40	0.40
(number of countries)	...	...	(8)	(10)
Argentina	...	...	0.63	0.53
Bolivia	...	...	...	0.65
Brazil	...	...	0.32	0.43
Chile	...	...	0.60	0.66
Colombia	...	...	0.36	0.50
Ecuador	...	...	0.12	0.13
Mexico	...	...	0.18	0.18
Paraguay	...	...	0.36	0.39
Peru	...	...	...	0.17
Uruguay	...	...	0.61	0.71

Reliance on the property tax in Latin American countries

(Percentages of subnational governments tax revenue)

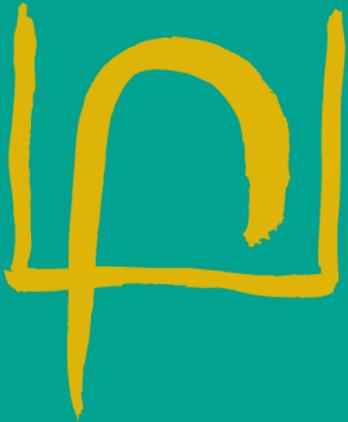
	1990s	2000s*
Latin American countries	36.6	40.9
(number of countries)	(8)	(10)
Argentina	18.5	13.8
Bolivia	...	59.3
Brazil	28.3	30.3
Chile	47.4	45.9
Colombia	32.2	30.4
Ecuador	39.0	29.0
Mexico	46.8	49.5
Paraguay	41.9	45.9
Peru	...	66.9
Uruguay	38.4	37.9

Source: ECLAC.



5. The role of central government and coordination mechanisms

The structural characteristics of Latin American economies coupled with the reallocation of functions require a strong coordination role by the central government. This role was particularly evident in three key aspects: promoting macrofiscal sustainability, addressing regional disparities, and articulating decentralized sectorial policies.



5. 1. Macro fiscal coordination

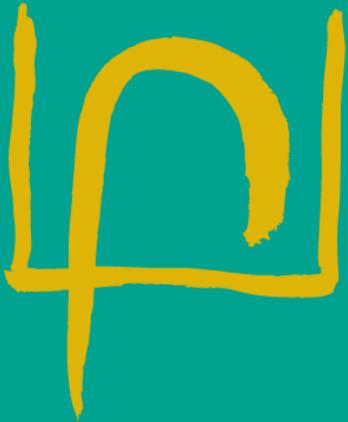
The recurrent macro crisis that the countries of the region have suffered tend to have their impact on intergovernmental relations. Intergovernmental fiscal relations often deteriorate when the economy receives either a financial (sudden stop) or a commercial shock.

Macrofiscal coordination

- Financial and commercial shocks affect intergovernmental relations through
 - Credit restriction
 - Decrease of intergovernmental transfers
 - Decrease of subnational revenues
- Distributional conflict between levels of government

Latin America and the Caribbean: Fiscal rules currently in force

	Country	Implementation date	Coverage	Type	Additional rules	Legal status
<i>Balance rule</i>	Argentina	2004	Federal and subnational	Nominal growth of primary expenditure must not exceed nominal GDP growth		Law
	Brazil	2001	Federal and subnational	Current equilibrium (subnational); primary surplus (federal)	Limits on wage expenditure (% of total)	Law
	Chile	2006	Central	Overall structural surplus (1% of GDP)	Pension Reserve Fund (FRP); Economic & Social Stabilization Fund (FEES)	Law
	Colombia	2001	Subnational governments	Current equilibrium	National Coffee Fund (FNC); Petroleum Saving and Stabilization Fund (FAEP)	Law
	Ecuador	2005	Federal and subnational	Real growth of current expenditure must not exceed 3.5%	Oil Stabilization Fund (FEP); Saving and Contingency Fund (FAC)	Law
	Mexico	2006	Federal and subnational	Current equilibrium	Oil Revenues Stabilization Fund (FEIP)	Law
	Peru	2003	National	Deficit below 1% of GDP; real growth of primary expenditure no more than 3% per year	Fiscal Stabilization Fund	Law
	Venezuela	2000	National	Current equilibrium	Macroeconomic Stabilization Fund (FEM)	Law
<i>Debt rule</i>	Argentina	2004	Subnational governments	Annual borrowing limits to ensure that debt servicing does not exceed 15% of current resources		Law
	Brazil	2001	Subnational governments	Annual borrowing limits		Law
	Colombia	1997	Subnational governments	Borrowing limits determined by solvency and liquidity indicators		Law
	Ecuador	2005	Federal and subnational	Timetable for reducing debt to 40% of GDP	Borrowing limits for subnational governments	Law

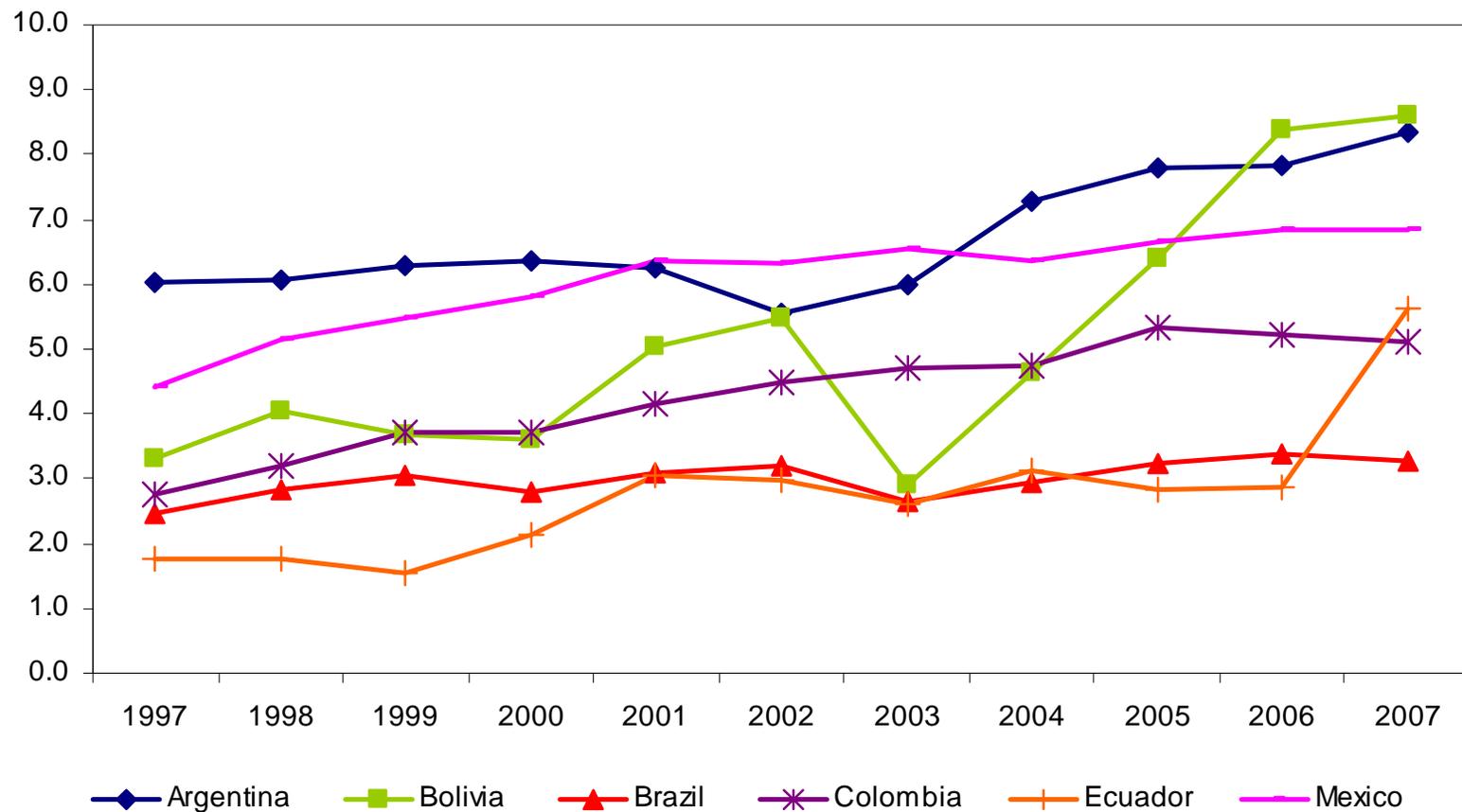


5. 2. Coordination mechanism: intergovernmental transfers

The high regional inequality together with fiscal asymmetries requires a central role in coordinating the intergovernmental fiscal system to meet most effectively the basic aims of public sectors.

The role of central government and coordination mechanisms

Transfers to subnational governments - Percentage of GDP



Source: ECLAC

Characteristics of the transfer systems in Latin America (77 systems analyzed)

	Number of Systems
Origin of Funds	
Percentage of national taxes	40
Lump sum	3
Variable amount (by cost of service)	5
Budget allocation	15
Other	14
Transfer Mechanism	
Discretionary	29
Automatic	48
Type of allocation	
Free availability	38
Sector allocation	39
Destination	
Intermediate governments	37
Local governments	44

Source: ECLAC

Intergovernmental transfers

- Allocation among the central government and intermediate government (Argentina, Venezuela)
- Allocation among the central government and different levels of subnational governments (Brasil)
- Systems which include revenues originated on natural resources (México, Perú)
- Systems with exceptions (Municipalities with port in Honduras)
- Horizontal distribution (Chile)
- Distribution incorporating different destinations to subnational governments (Universities in Bolivia)
- Distribution of funds originated in debt relief (Bolivia)



Intergovernmental transfers: criteria for distribution

- Fixed coefficients (Argentina)
- Variable coefficient with different level of complexity (México, Guatemala, Perú, Honduras)
- Sectorial indicators (Colombia)



Intergovernmental transfers: conditionality

- General conditions (Bolivia, El Salvador, Uruguay)
- Specific conditions (Brasil (FUNDEF and SUS), Argentina, Guatemala)
- General system of transfers with conditionality (Colombia, México)
- Matching grants (Honduras Social Investment Fund, Plan Nacer Argentina)



Final remarks and future challenges

- Decentralization for development
- Regional disparities and sub-national capacities
- Weakness of local revenues (property taxes)
- Micro fiscal issues: public expenditure management and accountability mechanisms
- Problems of evaluation



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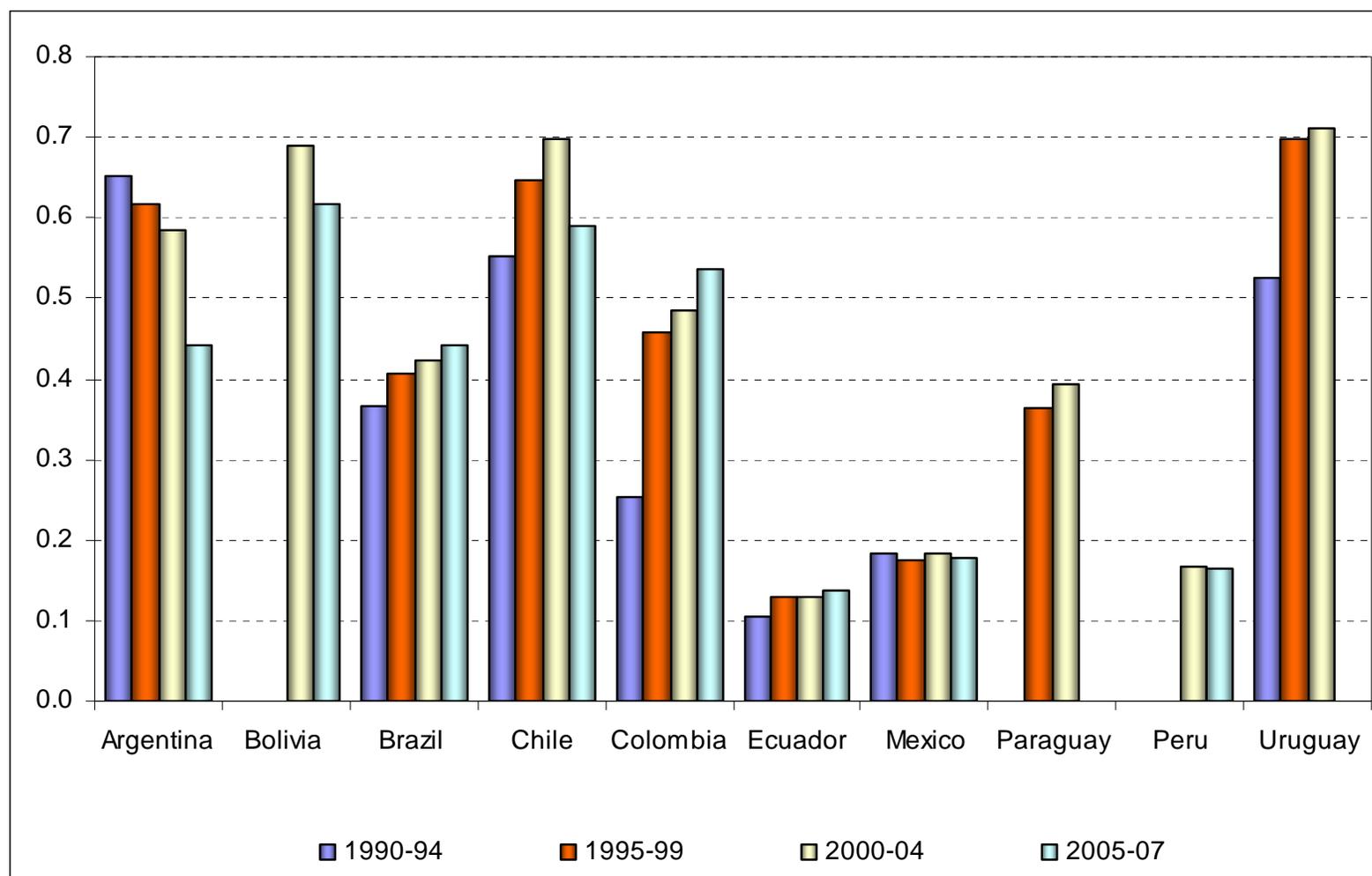
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Allocation of fiscal revenue

Subnational Taxes

	Intermediate government	Local government
Argentina	Turnover tax, property tax, automobile tax, stamp	Non tax revenues, services contribution
Brazil	VAT, fix amount on income tax, consumption tax	Services and property tax
Colombia	Excise taxes (beer, tobacco, liquor and gasoline)	Property tax, Industry and commerce tax, Gasoline (over rate)
Ecuador	“Alcabalas”, improvement contributions	Property tax, asset tax, “alcabalas”
Mexico	Automobile and partial payroll tax	Property tax, “patentes de giro”
Peru	Automobile tax, “patentes de giro”	Property tax
Venezuela		Property and automobile tax

The evolution of the property tax in Latin American countries (Percentages of GDP)



Source: ECLAC.