Latin America is facing an economic future characterised by low growth: according to the IMF, in 2015-2016 growth will average 0.9% compared with 3.7% annually on average in the period 2005-2014. This trend is the result of two negative shocks: falling commodity prices and a less favourable international financing environment for the region. But the medium-term prospects are not so encouraging either: the annual average growth expected for 2015-2020 is just 2.3%. Apart from debate regarding the need to define an agenda of structural reforms to boost the region's growth potential, this outlook has also raised doubts regarding the sustainability of public accounts. We will focus on the latter.

First of all it should be noted that the starting point for Latin America's public accounts is not positive. Whereas the public deficit climbed to 3.8% of GDP and public debt rose to 48.7% in 2009, a critical year affected by the recession, in 2014 they stood at 4.9% and 51.6% respectively. Such figures are historically high and
have also occurred within a context of quite dynamic growth (except for 2014, a year of slowdown). Also cause for concern is the fact that they are distributed quite alarmingly among the different countries in the region: Brazil, the region's main economy, has a deficit of 6.2% and public debt at 65.2% that place it among those countries at the most dangerous end of the spectrum.¹

The main reason for this deterioration is the trend in spending (excluding interest). In the region as a whole, according to data from the Inter-American Development Bank (IADB), between 2008 and 2014 this expenditure rose by a figure equivalent to almost 5% of GDP while revenue rose by a figure equivalent to just 1.5% of GDP. As can be seen in the graph, this upward trend in spending is fundamentally due to a notable increase in wages and salaries and in current transfers and subsidies, while investment has only grown appreciably in a few countries.

In short, both the current situation of the public accounts and also the growth prospects demand that Latin America accepts the need to carry out substantial fiscal adjustment. There are two immediate questions: how far should this adjustment go and what form should it take? With regard to the first question, the IADB concludes that the average Latin American country should carry out fiscal adjustment equivalent to 1.9% of GDP between 2015 and 2018 in order to stabilise its public debt at current levels. However, the average adjustment rises to 2.5% of GDP for those countries with debt above 40% of GDP. Although this adjustment may seem to be relatively acceptable, it should be seen as a minimum as many countries should actually try to push their public debt down to more comfortable levels.

With regard to the characteristics of such adjustment, the IADB itself proposes a strategy that protects the social progress made in the last few decades while also improving the sustainability of public accounts. Common features included in this kind of adjustment are to increase taxable income bases (a particularly pressing need in those countries with a larger informal economy), prioritise public investment, reduce inefficient expenditure and concentrate social spending on the most disadvantaged segments. For example, if social expenditure in Central America were allocated to the population within the bottom 40% of income
distribution, it is estimated that this would generate fiscal savings equivalent to 0.5% of GDP.

In conclusion, the challenge facing Latin America's public accounts is considerable. Beyond the strictly fiscal situation, neither should we forget that the region has changed in structural terms over the last decade and a half. In particular, the emergence of a new middle class is transforming the rules of the game: while it continues to demand an appropriate level of redistribution, it is also more aware of the importance of fiscal stability to ensure future prosperity.\(^2\) Hence the challenge.

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1. The thresholds for excessive public debt in the case of emerging countries are more demanding than for developed economies, partly due to the larger share of debt in foreign currencies.

2. According to data from Pew Research Center, between 2001 and 2011 63 million people had reached the middle income segment in Latin America, more than 10% of the region's total population.

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