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Fiscal Rules and the Behavior of Public Investment in Latin America and the Caribbean: Towards Growth-Friendly Fiscal Policy?

While fiscal policy has the potential to boost economic growth in Latin America and the Caribbean (LAC), distortions in public expenditure composition are contributing to reduce already low levels of public investment that could enhance growth. Rules-based fiscal frameworks, for example, have been widely adopted to constrain excessive deficits, and there is evidence that properly designed rules have been effective at improving fiscal performance around the world. When fiscal rules are poorly designed, however, pressure to comply with fiscal targets may lead myopic policymakers to reallocate spending away from items with longer-term benefits, including public investment.

Countries are consequently reforming rules-based fiscal frameworks by incorporating elements that could contribute to protecting public investment levels over time. Innovations include limits on the growth rate of current expenditures, mechanisms aimed at providing higher levels of policy adaptability in response to shocks, and excluding public investment from the perimeter of the fiscal target. Nonetheless, understanding how these rules operate in practice, their effects on policy outcomes, and potential tradeoffs requires in depth-country specific analysis.

With these concerns in mind, this network project seeks to i) to gain a deep understanding on the effects of fiscal rules in LAC at a country level with a special focus on growth-friendly expenditures (public investment) and ii) provide specific policy recommendations to improve fiscal rule design in the region.

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