

Fiscal Transfers in Latin America and the Caribbean: What Are Their Composition and Cyclicity Patterns?

A Project of the Latin American and Caribbean Research Network

The topic of the proposed Red de Centros is about fiscal transfer composition and its relevance in terms of its contribution to counter-cyclical fiscal policy. To what extent does the composition of fiscal transfers (unemployment insurance, conditional transfers, transfers to decentralized public entities, etc.) affect the ability of the government to conduct counter-cyclical fiscal policy?

Empirical evidence shows that spending policy (when using primary spending) has been typically pro-cyclical in developing countries (including LAC countries) and counter-cyclical in industrial countries. These policies tend to aggravate (ameliorate) output fluctuations in the developing (industrial) world. This basic stylized fact has been a source of heated debate in academia and policy circles regarding the motivations for such asymmetric behavior and, consequently, the mechanisms through which the developing world could escape the pro-cyclicity trap. Key insights point to the need to improve institutions, strengthen checks and balances, and increase access to capital markets (particularly in bad times).

Notably, not much attention has been paid (in a systematic manner) to the cyclical properties of spending composition. For example, when focusing on government consumption (i.e., excluding public investment and transfers from primary spending), this empirical regularity strongly changes. The developing world continues to be pro-cyclical, yet the industrial world becomes a-cyclical. Given that public investment is, in most cases, a small fraction of primary spending, the difference is mostly driven by fiscal transfers. This new insight implies that, on average, fiscal transfers are countercyclical in industrial countries. Put differently, the main reason why spending policy (when using primary spending) has been found to be counter-cyclical is due to the role of transfers as opposed to the behavior of government consumption. A possible reason for this behavior is that in most industrial countries an important part of these transfers involves automatic stabilizers (e.g., unemployment insurance and other social programs that are counter-cyclical by design).

The proposed Red de Centros aims at understanding the nature and role played by fiscal transfers in the region (comparing them with those observed in industrial countries). For this purpose it proves fundamental to have disaggregated fiscal data regarding fiscal transfers as well as country-specific knowledge to help understand and categorize the main objective of those transfers. To what extent are these transfers used as automatic stabilizers? Are they instead used for structural reasons, as would be the case of conditional cash transfers? This detailed study (and its comparison with the evidence of industrial countries) will be extremely useful for policy formulation, and it will allow for an analysis of the cyclical properties of transfers.

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