# Spend Better, Not More: Expenditure Policy in Latin America

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Latin America's fiscal response to the 2008–09 global financial crisis resulted in a sizable spending increase. But there was no real exit plan and this fiscal expansion has become permanent. Since then, most countries in the region have not fully restored their fiscal space, which weighs on their ability to respond to future shocks.

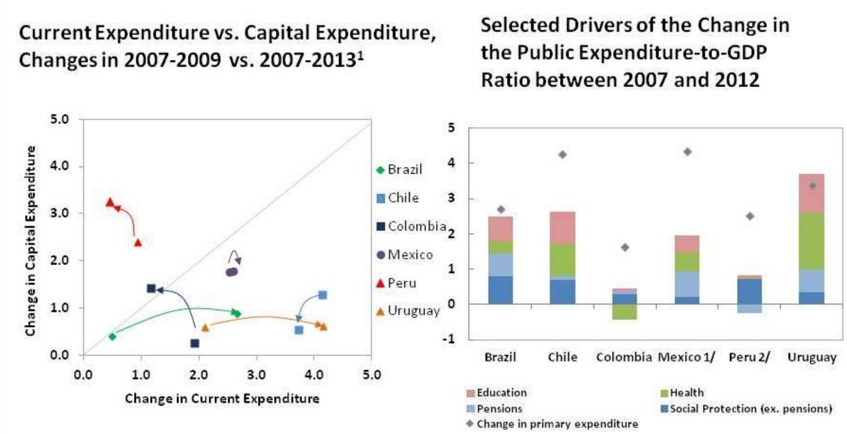
So, how can these countries strengthen their fiscal buffers without jeopardizing development and growth? A recent IMF study sheds light on this question, focusing on the six large emerging markets in Latin American—Brazil, Chile, Colombia, Mexico, Peru, and Uruguay. It finds that tackling spending inefficiencies can go a long way to contain spending pressures while creating fiscal space.

**The anatomy of the fiscal expansion**

Much of the 2009 fiscal easing implemented by these six countries during the crisis came from a sizable step-up in spending. As growth recovered, however, the increase in spending was not reversed. On average, the spending-to-GDP ratios in 2014 were 4 percentage points higher than in 2007.

The main drivers of the spending increases varied greatly across the region (Chart 1). They included higher social protection in Brazil and Peru; health and education spending in Chile and Uruguay; and pensions in Mexico. What is common for most countries is that much of the spending increases stemmed from current outlays (spending on items that are consumed and only last a limited period of time). Why does this matter? It matters because current spending is usually more inertial (like public wages or pensions), or politically harder to reverse (like social protection or health care). It also matters because such fiscal rigidity limits the options for rebuilding fiscal space when needed.

**Chart 1. Spending Increases Were Mostly Driven by Current Expenditure**




Sources: Sources: National authorities; and IMF staff calculations.
1/ The starting points show the changes in spending between 2007 and 2009. Arrows show changes in expenditure between 2009 and 2013.

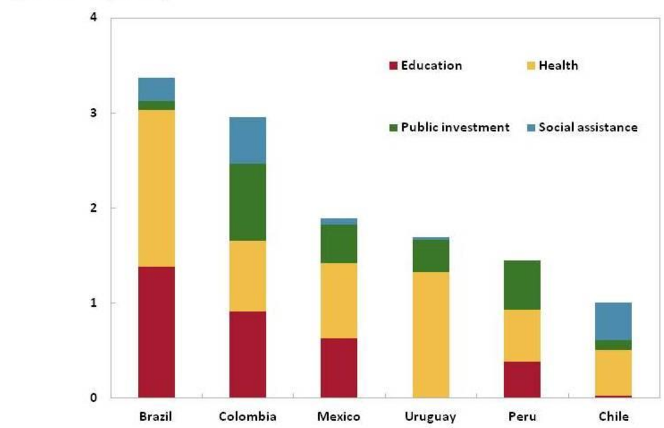
Sources: National authorities; World Development Indicators, The World Bank; and BADEINSO.
1/ Changes between 2007 and 2011.
2/ Changes between 2007 and 2011 for education and between 2007 and 2010 for social protection and pensions.

**The key is to spend better**

Today, with the commodity cycle ending and U.S. interest rates set to rise soon, the room for fiscal maneuver is at a high premium. At the same time, the region is facing important social and infrastructure needs. Thus, the challenge is to strengthen fiscal buffers without jeopardizing development goals.

Here, raising spending efficiency holds great potential. It can help contain or even reduce public spending in the longer term without undermining social and economic development. Higher efficiency can be achieved by both improving the allocation of spending across different sectors and raising the effectiveness of spending within each sector.

**Chart 2. The Region Has Ample Scope to Improve Efficiency of Public Spending**
**Illustrative Savings from Improving Efficiency**
(*percent of GDP*)




Source: IMF staff calculations.

For illustrative purposes, we estimated potential fiscal savings for the six countries if they were able to achieve the public spending efficiency of the best emerging market performers in education, health, and infrastructure, and the regional average efficiency in social assistance. Our results imply that the fiscal savings could range between 1 percent of GDP in Chile to 3¼ percent of GDP in Brazil (Chart 2).

*Education* outcomes are relatively good in the six countries given public education spending levels. Uruguay and Chile appear to be particularly efficient. Peru and Mexico are slightly inefficient, whereas Colombia and Brazil have ample room to improve efficiency. *In health,* efficiency levels are above the emerging market peers, although the same health outcomes could be attained by spending significantly less. As for *infrastructure*, the level and efficiency of public investment varies widely across countries. Brazil, Chile, and Uruguay, with low levels of public investment, appear to be relatively efficient. Colombia, Mexico, and Peru, on the other hand, could obtain sizeable gains. *Social assistance* spending in the six countries seems to be generally well targeted with the exception of Colombia.

While the potential for efficiency savings seems to be large, achieving those savings will not be easy. This will require demanding structural reforms. The specifics vary for each country and range, for example, from better aligning hospital capacity with need to coordinating investment plans among different levels of governments. Identifying the full set of steps towards more efficient spending will certainly take time. Thus, it is better to start early.

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