



Reactions to the Crisis: The Implementation of Counter Cyclical Policies in Latin America

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What is this about?

- 1. It is about the 2008 -2009 crises**
- 2. Its about Latin America and the Caribbean**
 - Countries with fiscal space (manageable debt)**
 - Without large automatic stabilizers**



IMF Position Note (December 2008)

1. Fiscal stimulus needed (around 2% of GDP)
2. Preference of expenditures over tax cuts
3. Repair, maintenance and delayed projects
4. Government larger share in PPP
5. Careful management of policies aim at disposable income.



Design & Implementation

1. Macro side: Nature of the Crises (demand vs Supply).
2. Fiscal Space
3. Macro monitoring and action taken
4. Execution side: Legal approval
5. Off balance vs in budget
6. Current vs investment expenditure.
7. Efficient vs effective expenditure
8. Subnational expenditure



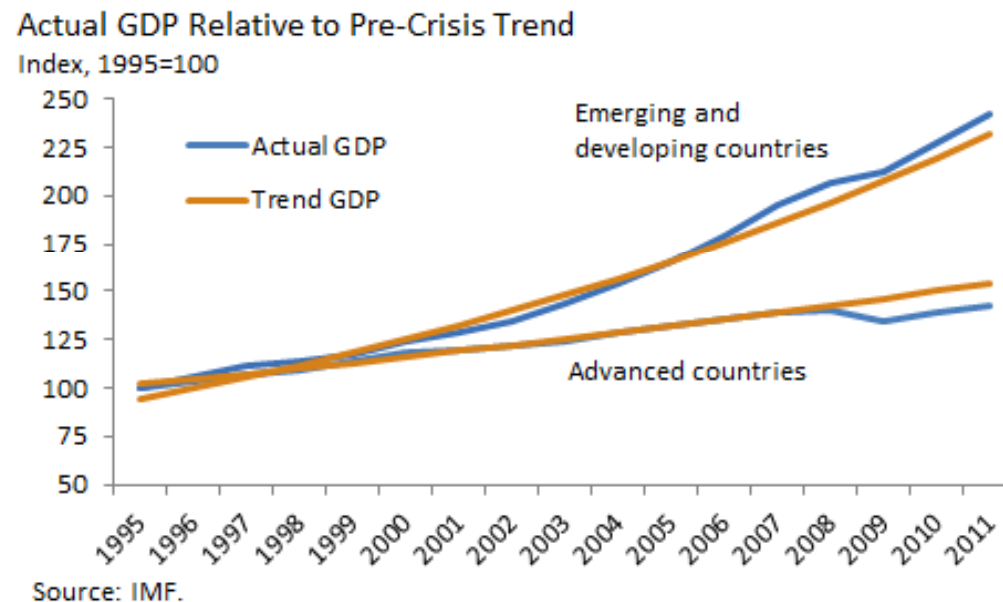
Reactions to the Crisis

- 1. Reactions to the Great Recession**
- 2. Mixed Results Within LAC**
- 3. Some Key Lessons from the Crisis**
- 4. Fiscal Tools for Short-Term Stimulus:**
 - 1. Management of Counter-Cyclical Funds**
 - 2. Management of Timing and Diagnostic of Crisis**
 - 3. Management of Expenditure Burning Rate**
 - 4. Management of Bottlenecks in Implementation Capacity**

The “Great Recession”: Not So Great for Everybody...



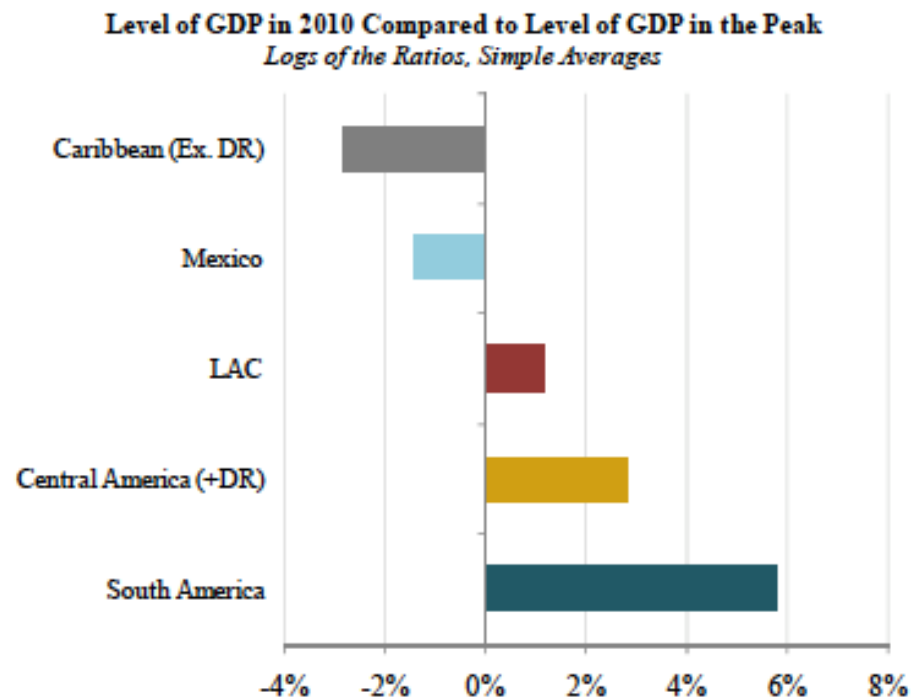
- The Great Recession started in Dec. 2007, and ended in June 2010: the longest since World War II (NBER)
- However, it had an asymmetric impact.



Even Latin America Had Different Stories to Tell...



- The recovery of Mexico and the Caribbean was very different to the one in South America



Source: World Bank, 2011

Some Consensus is Emerging from this Crisis



- **Lesson 1:** “We need fiscal tools for short-run stabilization”.
- **Lesson 2:** “We have even stronger evidence that fiscal policy is effective than we did before the crisis”.
- **Lesson 3:** “[*ex ante*] Fiscal Space is valuable”.
- **Lesson 4:** “Political-economy considerations are extremely important”.



David Romer (Berkeley)

In Blanchard, Romer, Spence, and Stiglitz, “In the Wake of the Crisis: Leading Economists Speak Out”. Cambridge University Press (2011)

Fiscal Tools for Short-Run Stabilization



- **“Counter-Cyclical Funds”**: Rule-based, Commodity-financed Sovereign Funds
- **Automatic Stabilizers**: Unemployment Insurance, Conditional-Cash Transfer Programs, etc.
- **Fiscal Stimulus Packages incorporated to the Annual Budget**: (But it needs to go through all the budget cycle and get parliamentary approval... more a medium-term measure).

...But They All Need Both Fiscal Space and Implementation Capacity to Work...

LAC Counter Cyclical Funds

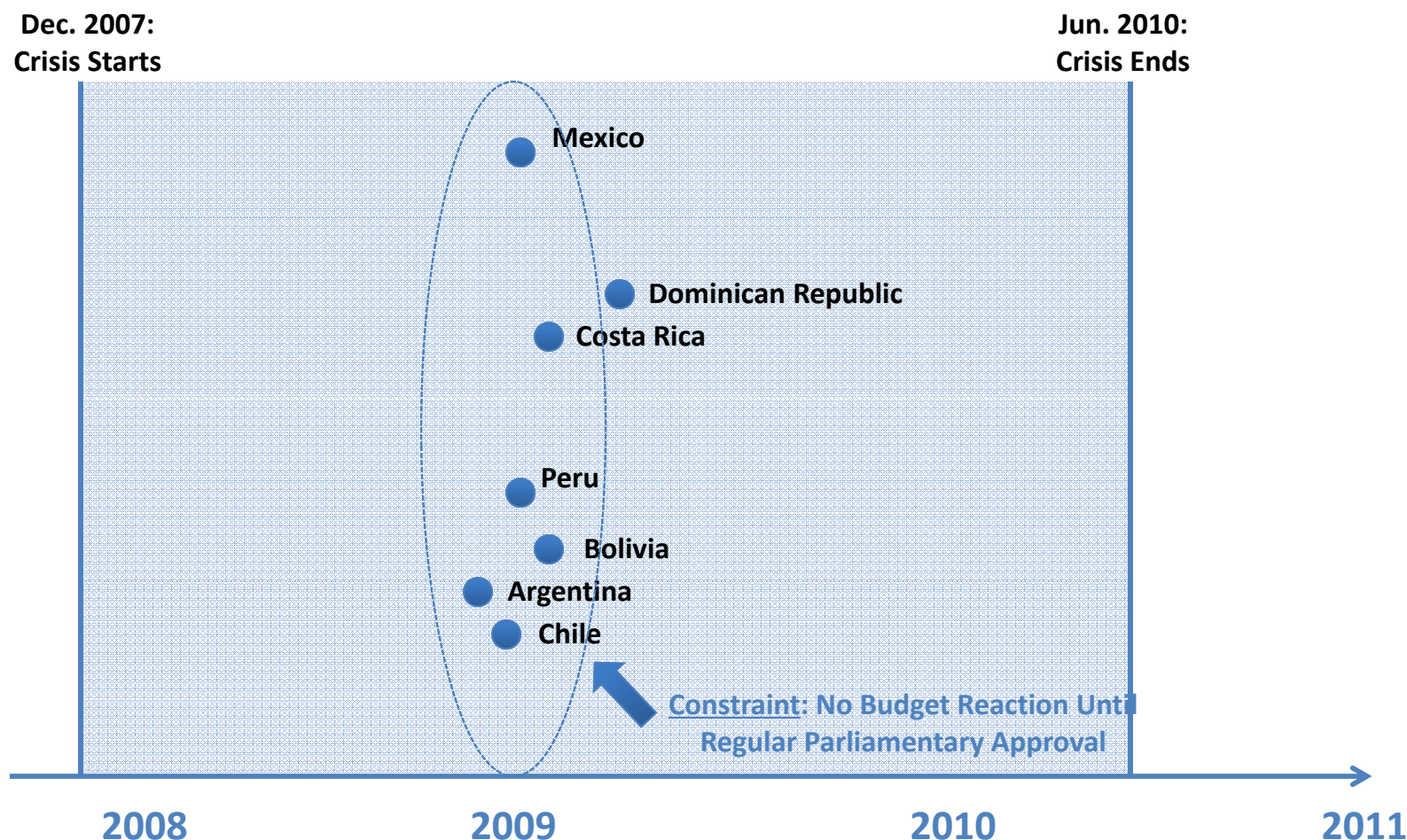


- **Example of Chile:** The Government conducted a rule-based countercyclical fiscal policy, accumulating surpluses in sovereign wealth funds during periods of high copper prices and economic growth, and allowing deficit spending only during periods of low copper prices and growth.
- As of Sept. 2008, those sovereign wealth funds (kept mostly outside the country and separate from Central Bank reserves) amounted to **more than \$20 billion**.
- Chile used **\$4 billion** from this fund to finance a fiscal stimulus package to fend off the Great Recession.

Timing: Early Identification of the Crisis and First Budget Measures



- **Announcing Specific Measures Against the Crisis:**



Source: World Bank (2010)

Speed: Stimulus Budget Burning Rate



- **Type of Expenditure Matters:**
 - **Current Expenditures:** Implementing increases was easier and faster... but they are hard to revert (eg. *Teachers' salaries*).
 - **Investment Expenditures:** They require a readily available pipeline of high-value added investment projects. Few countries in LAC had one.
 - **Korean lesson:** *Appropriate planning and pipeline*

Implementation Capacity is Key



- **Fiscal Space and Implementation Capacity** could be the two strongest predictors of a country's reaction to present and future crises

Real Capacity to React to the Great Recession in LAC

Budgetary Agility	High	Caribbean <i>Response: Defensive Restructuring</i>	Chile, Peru <i>Response: Stimulus + Restructuring</i>
	Low	Central America <i>Response: No Response, High Volatility to Market Trends</i>	Argentina, Brazil, Mexico <i>Response: Stimulus + Restructuring</i>
		Low	High
		Fiscal Space (2009)	

Construction of a Narrative Approach



- 1. Identification of the crises & approval of the package (initial fiscal position)**
- 2. Consistency of the projects (revenue and expenditure side)**
- 3. Countercyclical funds vs. special package**
- 4. Implementation of the package**
- 5. Rules of implementation (procurement laws, exceptions?)**
- 6. Large vs small projects**
- 7. Subnational dimension**
- 8. Tracking of specific projects within the package**
- 9. Lessons learned**



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