Fiscal rules set the passage for a country's responsible fiscal policy. Over the last years, LAC countries implemented fiscal responsibility laws in order to improve the sustainability and transparency of fiscal policy and to increase economic growth. Fiscal rules are meant to be observable and permanent, irrespective of changes in government; hence they can help prioritise a predictable track for government policy and keep public debt at healthy levels.

Fiscal rules act as a commitment mechanism to constrain excessive deficit accumulation arising from distorted political incentives; nonetheless, strict rules might reduce the scope for adjusting policy to unexpected shocks. Recent research (Ardanaz et. al., 2019) found that flexible fiscal rules can contribute to reduce procyclical biases against public investment, which is generally the most affected type of spending in periods of fiscal adjustment.

The vast majority of LAC countries have budget balance rules, which can be in terms of nominal and primary budget balance, structural balance and golden rule. More countries than in 2013 have such rules. Out of the surveyed countries, only the Bahamas and Uruguay do not have any type of fiscal rules for budget balance in place, and Argentina has a political commitment to have primary budget balance rules in place. While the headline/nominal balance rule is the most common in LAC, structural or cyclical balance is the most common one among OECD countries.

In LAC, debt rules are sanctioned in the majority of the countries, although only in 4 out of 13 are they sanctioned by law. By contrast a majority of OECD countries sanction them by law (i.e. debt ceiling in a level or as a percentage of GDP, debt target in level or as a percentage of GDP and debt reduction target). Debt rules have been sanctioned by law in El Salvador, Mexico, Panama and Peru. Paraguay, which did not have any debt rules in 2013, established debt ceilings.

A large proportion of LAC countries have established expenditure rules in order to limit the size of the government since 2013. Expenditure ceilings are more common than expenditure growth rates (the opposite of the OECD). Fiscal rules on revenue are less popular in LAC (as well as among OECD countries). Costa Rica, Mexico and Paraguay have rules, grounded in laws, for upper limits on revenue, and Brazil, Mexico and Paraguay also set constraints on allocation of higher than expected revenues. Brazil and Paraguay did not have such rules in place in 2013. Since 2016, Peru has a rule stating that current expenditures cannot exceed current revenues.

For compliance to take place, some countries have enforcement mechanisms defining the procedures to follow in the event of a deviation from the rule. El Salvador, Panama, Paraguay and Peru enforce corrective measures to be implemented by the entity responsible for the overrun. The Bahamas, Mexico and Panama set up a requirement to explain the reasons for non-compliance to the Legislature. The most common enforcement mechanism among OECD countries is proposing corrective measures to the Legislature. In LAC, this is also the case in the Bahamas and Panama. Brazil imposes automatic corrective measures once a fiscal rule has been violated. Currently, Argentina, Chile and Costa Rica reported not having enforcement mechanisms in place.

### Methodology and definitions

Data come from the 2018 OECD/IDB Survey of Budget Practices and Procedures to which 11 LAC countries responded and 2018 OECD Survey of Budget Practices and Procedures, which collected data for Chile and Mexico. Data for the OECD refer to 34 respondent countries. Respondents were predominantly senior budget officials in LAC countries and OECD member countries. Responses represent the countries' self-assessments of current practices and procedures. Data refer only to central/federal governments and exclude the sub-national level.

A fiscal rule is a permanent, long-term restriction on fiscal policy aggregates. The majority of fiscal rules are based on international treaties, constitutional decrees, or primary legislation. In exceptional cases, fiscal rules can be based on political commitments. However, the commitment must be solid and involve all relevant actors in the long run. In sum, the fiscal rule is meant to be applied on a permanent basis by subsequent administrations. This is distinct from a "fiscal objective", which is a target that is not legally binding but mandated through political decision or established custom and practice.

A golden rule is a variation of a balance rule, in which the government is only allowed to borrow to finance investments. The rationale underlying the golden rule is that investments represent future and not current consumption and have the potential to generate future growth.

### *Further reading*

Ardanaz, M., E. Cavallo, A. Izquierdo and J. Puig (2019), *Growth-Friendly Fiscal Rules?: Safeguarding Public Investment from Budget Cuts through Fiscal Rule Design*, Inter-American Development Bank *http://dx.doi.org/10.18235/0001804*

Fall, F., et al. (2015), "Prudent debt targets and fiscal frameworks", *OECD Economic Policy Papers*, No. 15, OECD Publishing, Paris, *https://doi.org/10.1787/5jrxtjmmt9f7-en*.

### *Figure notes*

Data for Bahamas and for Uruguay for 2013 are not available.

5.6. (Types and legal foundation of fiscal rules, 2013 and 2018) is available on line in Annex F.

## 5.4. Types and legal foundation of fiscal rules by rule, 2018

| Country | Budget balance (deficit/surplus) | | | | Debt | | | Expenditure | | Revenue | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Headline/ nominal budget balance | Primary budget balance | Structural/ cyclical budget balance | “Golden rule” | Debt ceiling in a level or as a percentage of GDP | Debt target in a level or as a percentage of GDP | Debt reduction target | Expenditure level/ceiling | Expenditure growth rate | Upper limits on revenue | Constraints on allocation of higher than expected revenues |
| Argentina | x | ❍ | x | x | x | x | x | x | x | x | x |
| Bahamas | x | x | x | x | x | x | x | x | x | x | x |
| Brazil | ⦿ | ⦿ | ⦿ | ⦿ | ❍ | ❍ | ❍ | ⦿ | ⦿ | ❍ | ⦿ |
| Chile | x | x | ✠ | x | x | x | x | ⦿ | x | x | x |
| Costa Rica | ⦿ | x | x | x | ✠ | ✠ | ❍ | ⦿ | ✠ | ⦿ | x |
| Dominican Republic | ⦿ | ⦿ | x | x | x | x | x | ⦿ | x | x | x |
| El Salvador | ⦿ | ⦿ | ⦿ | x | ⦿ | ⦿ | ⦿ | ⦿ | ✠ | x | x |
| Guatemala | ⦿ | ✠ | x | x | ✠ | ✠ | x | ❍ | ❍ | ❍ | ❍ |
| Mexico | ⦿ | ⦿ | ⦿ | x | ⦿ | ⦿ | ⦿ | ⦿ | ⦿ | ⦿ | ⦿ |
| Panama | ⦿ | x | x | x | ⦿ | ⦿ | ⦿ | ⦿ | x | x | x |
| Paraguay | ⦿ | ⦿ | ⦿ | ⦿ | ⦿ | x | x | ✠ | x | ⦿ | ⦿ |
| Peru | ⦿ | x | x | x | ✠ | x | x | x | ⦿ | x | x |
| Uruguay | x | x | x | x | x | x | x | x | x | x | x |
| **LAC total** | | | | | | | | | | | |
| ⦿ Legal Basis | 9 | 5 | 4 | 2 | 4 | 3 | 3 | 7 | 3 | 3 | 3 |
| ✠ Internal rules/policy | 0 | 1 | 1 | 0 | 3 | 2 | 0 | 1 | 2 | 0 | 0 |
| ❍ Political commitment | 0 | 1 | 0 | 0 | 1 | 1 | 2 | 1 | 1 | 2 | 1 |
| x Not applicable | 4 | 6 | 8 | 11 | 5 | 7 | 8 | 4 | 7 | 8 | 9 |
| **OECD total** | | | | | | | | | | | |
| ⦿ Legal Basis | 20 | 6 | 22 | 1 | 20 | 14 | 14 | 16 | 18 | 6 | 11 |
| ✠ Internal rules/policy | 2 | 2 | 2 | 0 | 0 | 3 | 0 | 2 | 3 | 1 | 0 |
| ❍ Political commitment | 6 | 0 | 3 | 1 | 0 | 6 | 3 | 3 | 2 | 2 | 1 |
| Other basis | 0 | 1 | 1 | 0 | 0 | 1 | 1 | 0 | 0 | 0 | 0 |
| x Not applicable | 7 | 25 | 6 | 32 | 14 | 11 | 16 | 13 | 11 | 25 | 22 |

*Source*: OECD/IDB (2018) Survey of Budget Practices and Procedures, OECD (2018) Survey of Budget Practices and Procedures.

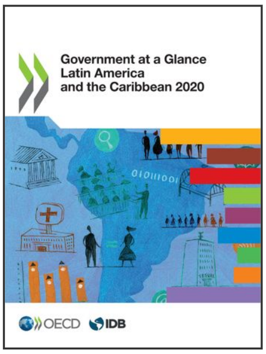
StatLink https://doi.org/10.1787/888934091885

## 5.5. Enforcement mechanisms for fiscal rules, 2013 and 2018

| Country | Corrective measures implemented by the entity responsible for the overrun | Requirement to propose corrective measures to the Legislature | Requirement to explain the reasons for non-compliance to the Legislature | Automatic corrective measures (e.g.sanctions) | No enforcement procedures defined ex ante |
|---|---|---|---|---|---|
| Argentina | | X | | | ○ |
| Bahamas | | ○ | ○ | | |
| Brazil | X | | | ○ | |
| Chile | | X | | | ○ |
| Costa Rica | | | | | ○ X |
| El Salvador | ○ | | | | |
| Mexico | X | | ○ | | |
| Panama | ○ X | ○ | ○ | | |
| Paraguay | ○ | | | | |
| Peru | ○ | X | | | |
| **LAC total** | | | | | |
| ○ 2018 | 4 | 2 | 3 | 1 | 3 |
| X 2013 | 3 | 3 | 0 | 0 | 1 |
| **OECD total** | | | | | |
| 2018 | 9 | 18 | 14 | 5 | 7 |

*Source*: OECD/IDB (2018) Survey of Budget Practices and Procedures, OECD (2018) Survey of Budget Practices and Procedures.

StatLink https://doi.org/10.1787/888934091904

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