

CEPAL

REVIEW

NUMBER 63
DECEMBER 1997
SANTIAGO, CHILE

OSCAR ALTIMIR
Director of the Review

EUGENIO LAHERA
Technical Secretary



UNITED NATIONS

CONTENTS

The public sector's role in Latin American development <i>Ricardo Carciofi</i>	7
Equity in the public budget <i>Juan Martin</i>	17
Pension system reforms, the capital market and saving <i>Andras Uthoff</i>	29
Public institutions and explicit and implicit environmental policies <i>Nicolo Gligo</i>	51
Non-market valuation of natural and environmental resources in Central America and the Caribbean <i>Steve Shultz</i>	65
An integrated macro-model for the Caribbean subregion <i>Lucio Vinhas de Souza</i>	77
Swerves and skids by the Venezuelan economy <i>José Miguel Benavente</i>	85
How non-traditional are non-traditional exports? The experience of seven countries of the Caribbean Basin <i>Alberto Gabriele</i>	99
Trade openness and structural change in the Brazilian motor industry <i>Ruy de Quadros Carvalho, Sérgio Robles Reis de Queiroz, Flávia Luciane Consoni, Ionara Costa and Janáina Pamplona da Costa</i>	115
The ongoing history of a Chilean metal products and machinery firm <i>Jorge Katz and Héctor Vera</i>	129
The importance of local production and small-scale enterprises for Latin American development <i>Francisco Albuquerque</i>	147
Recent ECLAC publications	162

Equity in the *public budget*

Juan Martin

*Director of
Public Sector Planning,
Latin American and
Caribbean Institute for
Economic and Social
Planning (ILPES).*

This article aims to make a "walk-through" in the virtual reality of budgetary and fiscal matters in order to identify the possible leeway for achieving a higher level of convergence between the public discourse on equity and the real content of public policies aimed at that goal. To this end, the author explores possible answers to four questions: what is the current meaning of the concept of equity?; how much leeway is there in the field of taxation for expanding resources and improving vertical equity?; how can priority be given to the objective of equity in managing public expenditure?; and how could greater dynamic consistency be ensured between growth and equity? He concludes that it would be possible to make considerable progress in terms of social equity in the fiscal field, but this would call for top-level political will, backed up by active public policies in a serious, sustained and consistent effort. In order for that political will to go beyond the levels of mere declarations or clientage, it must be directed towards society at large, clearly setting forth the priorities involved, and in order to avoid it being frustrated, it must be based on operational methods that combine social participation with the creative and judicious use of public policy instruments.

I

Introduction

The question of equity in the public budget is very broad and admits of various different approaches. As it seems prudent to limit it somewhat, the analysis in this article will be centered on the leeway available within the area of public finances for tackling the need for advances in social equity.

This approach, although limited, is nevertheless important because fiscal policy –through its income, expenditure and financing components– has considerable effects on equity. We must not ignore the fact that fiscal action is not enough, however. Well-paid employment is undoubtedly the most effective means of promoting greater equity; at the same time, the amount and quality of employment are connected with elements belonging to other fields as well as that of fiscal matters. All these factors were integrated by ECLAC into its proposal for changing production patterns with social equity (ECLAC, 1990 and 1992).

In order to place the analysis in context, it should be recalled that many of us view the immediate past of the region in terms of two synthetic concepts: that of the lost decade, if the accent is placed on the economic and social results of the 1980s as compared with those of previous decades, and that of the years of painful learning, if the emphasis is placed on the lessons learned in order to face the future (Martin, 1994).

Both of these views of our immediate past are valid, but what is even more important is that they are complementary to each other. One of them reminds us of the problems which have still to be solved, subject of course to their different importance according to the conditions of each country and the position of the observer himself. The other –that of the painful learning process– sums up what we have learned. I think there are four lessons to be highlighted in this respect.

The first of these is that social compensation measures must interact and adapt themselves in time with programmes of investment in human capital. Compensatory measures are designed to attend to needs which cannot be put off any longer and come under the concept of a social safety net. Investment

in human capital, for its part, is designed to recover the lost ground in terms of social progress in the region in order to face more effectively the challenges imposed by the world of today.

The second lesson is that the result of a decade which has been very active in matters of tax reform has been a clear re-ordering –in a manner different from the past– of the elements making up the trinity of tax objectives: efficiency, simplicity and equity of the tax system. The question of equity has not only lost the leading place it had in the 1960s and 1970s but has also undergone a big change in emphasis.

The third lesson is that in situations of severe fiscal constraints, the concepts of the priorities, replacement and productivity of public expenditure become more important. We often know that we are spending our resources badly, but what is worse, sometimes we do not even know exactly what we are spending them on.

The fourth and last lesson is that fiscal matters have taken on great importance in the achievement and maintenance of the basic macroeconomic balances, which are nowadays considered as an indispensable intermediate objective for the attainment of sustainable growth. This brings us in turn to the need to harmonize the different components of fiscal policy –public income, expenditure and financing– and to coordinate their management over time more effectively.

Let us now see how to use these four lessons in analysing the social inequity which, although a very long-standing problem in the region, has got worse –and perhaps changed its nature– since the lost decade. We shall keep to a set of conceptual aspects which will help us to examine the policy options and trade-offs in this respect.

A warning is called for here: our starting point is the perception that the concern for equity is greater in the political discourse than in the actual content of public policies, so we propose to make a tour of the “virtual reality” of the budgetary and fiscal area in order to identify degrees of leeway which could make possible closer convergence between the political discourse and the actual reality.

II

Equity: a single undivided concept?

The incipient recovery in growth and the better fiscal situation of the early 1990s, contrasting with the visible signs of imbalance in the social distribution of the costs of the adjustment begun in the 1980s, have raised the question of equity once again. The present debate on this matter is more heated for two reasons connected with the expectations of the population in both the economic and political spheres. On the one hand, the substantial progress made in the macroeconomic field has not been accompanied by convincing progress in the social situation. On the other, the difficulty experienced by governments in putting together sufficiently powerful proposals to match the magnitude of the problem has meant that the political debate which is essential for making progress in this field has not been very fruitful.

Although most fiscal actions have repercussions on equity, the government discourse in this respect is focussed in particular on public policies aimed at the so-called social sectors. Thus, a new model of public action in the social field has begun to take shape in the region, whose instruments are usually grouped together under the titles of privatization, targeting and decentralization. The first two of these form the heart of the strategy: the aim is to introduce market mechanisms into the provision of social services as far as possible, and to limit the direct public supply of such services to the most vulnerable social groups, by the targeting of expenditure. Decentralization, as the third component of the model, strengthens the movement towards a more prominent role for social subgroups—in this case the local communities—in the systems for the provision of such services. Some brief comments are called for regarding these three components.

1. Decentralization

Decentralization will very likely bring significant gains in efficiency and greater social control over the provision of services, provided that it facilitates community organization and participation and that the subnational levels of government show themselves to be open to it. This is a point which is difficult to

clarify in advance in any of the countries of the region.

At the same time, the responsibilities transferred from the central government to the subnational levels of government must be in keeping with the financial resources available. Consequently, in most cases it will be necessary to reach some kind of agreement on fiscal decentralization which will be consonant with the maintenance of this balance. The recent experience of the region shows serious imbalances in one direction or the other.

Finally, simultaneous decentralization to social subgroups which are defined on a territorial basis and are necessarily heterogeneous among themselves may give rise to cases of inequity between such subgroups as regards the quantity and quality of the services provided, because of differences in technical and administrative capacity, the resource endowment, the organizational potential of the community, and the openness of the government to citizen participation, among other factors.

These concerns should not be interpreted as arguments against decentralization, since this represents an important way of making public management more democratic and efficient. They do, however, represent arguments against some views which see decentralization as an end in itself or which support spontaneous mechanisms for the spread of decentralization which implicitly dilute responsibilities.

The change from a centralized to a decentralized system of provision of social services requires a strategy for the transition and also calls for effective regulation once the new system has been established. Otherwise, the expectations regarding its potential may be frustrated, or, even worse, decentralization may come to be discarded as a suitable direction for change.

It should perhaps be recognized, in this respect, that decentralization does in fact bring about a reordering of functions in the State machinery as a whole (Martin and Núñez del Prado, 1993). It is therefore not just a question of strengthening the technical and institutional capacity of the bodies to which responsibilities are decentralized, but also of redefining and

reorganizing the functions of the central and sectoral bodies in order to formulate policies with national coverage, defining regulations and monitoring their fulfillment, promptly exposing serious deviations of the quality of decentralized management from national standards, and providing the necessary means for applying corrective support measures.

2. Privatization and targeting

We will now return to the elements that lie at the heart of the new model proposed for public action in the social sectors: privatization and targeting. This model can make some significant contributions in respect of these two components, especially by suggesting a variety of instruments which have been little used so far.

Thus, with regard to privatization, as well as highlighting the advantages of the market in terms of resource allocation, it points out the importance of introducing systems for the total or partial recovery of costs, subsidizing demand, making supply more flexible by the incorporation of private suppliers, subcontracting the supply of inputs, and introducing incentives to increase the spirit of competition in public bodies.

With regard to targeting, the model gives a valuable reminder of the need to reduce poverty, since this is the worst manifestation of inequality that can exist in a society; thus, it emphasizes that priority must be given to the fight against poverty by directing various social programmes towards the establishment of an effective social safety net for the segment of the population with the most extreme unmet needs.

In both cases, however, the contributions usually form part of implicit policy recipes whose difficulty lies not so much in the partial nature of their aims as in their frequent omission of some items. We will highlight three of these through the following questions:

Does the new public action model assign a subsidiary role to the State, or does it call for active public policies in the social sphere? Particularly in the area of social policy, it is not desirable to present the market as a concept opposite to that of public intervention, contrasting the virtues of one with the shortcomings of the other; in this case in particular, experience shows that there are both market flaws and flaws in the actions of the government.

In reality, the important thing is to find ways of making better use of the great variety of instruments which are available for organizing novel mixed forms of supply of social services, with systems of incentives based on market criteria and modern forms of public regulation (Carciofi and Beccaria, 1995). It should also be remembered that neither the market nor public action operate in an abstract world, but in a complex set of concrete institutions. In this real world, the past history and dynamics of processes are important and make up a set of mutual conditioning factors which make necessary trade-offs between the objectives of equity and efficiency in social policy.

Is the struggle against poverty merely a priority objective or is it the only objective of public intervention in the social field? The traditional model of public action in the social field did not give special priority to poverty, but considered it rather as an extreme case of inequality of income distribution on which to center its attention; in contrast, the new model assigns absolute priority to public action against poverty. Both these positions are extreme ways of considering the relation between equity and poverty as grounds for public action.¹

Both from the theoretical and from the practical point of view, public intervention is justified by considerations of equity with respect to society as a whole, and not just by the existence of large groups which are in a poverty situation, although these groups merit preferential attention from social policy. Because of the challenges of present-day development, it is also important to build up the store of human capital, and in order to do this it is necessary to promote the potential talents which exist in society by seeking to eliminate inequality of opportunities and discrimination throughout the whole of society.

Is the important thing to ensure that social expenditure is properly targeted, or is the way its

¹ The relation between poverty and equity is viewed in the light of four different schools of thought. One school consists of those who are only concerned with poverty, without concerning themselves at all with inequality above the poverty line. The second school consists of those who see the reduction of inequality as an important objective of public policy, but give higher priority to the elimination of poverty. The third school consists of those who are concerned with both equity and poverty and are willing to consider trade-offs between the two objectives. Finally, there are those who do not give special importance to poverty but merely consider it as a component of the broader cost of inequality (see Atkinson, 1989).

financing is shared also important? Advocates of the focusing of public expenditure on the poorest sectors of society consider that the amount of resources available, and especially the social groups in which the financing of that expenditure is generated, are given data. The question of who is to pay for the focusing is highly relevant, however, both from the point of view of those who actually contribute to the financing of public ex-

penditure and those who are excluded from the benefits of social policy.

Both these dimensions have important consequences for social equity in the broader sense mentioned earlier, of course. As we shall see in the following section, when we compare the Latin American and Caribbean region with others we see that there is a good deal of room for increasing the tax burden and spreading it more equitably.

III

Taxation and equity: has the vertical dimension been lost?

The 1980s was very rich in tax proposals, reforms and experiments; many of them came from the developed countries and reflected their conditions both in the instruments used and also the objectives pursued by the reforms (Gómez, 1991).

1. The general lines of the reforms

These objectives shifted the central concern of the discussions from the equity of the tax system to its efficiency, within the context of a generalized reappraisal of the market mechanisms and the role of price systems. Within this approach, the concept of efficiency was equated with that of neutrality: hence, seeking a more efficient tax system means seeking a more neutral system, that is to say, one which has the least possible impact on economic decisions.

This leads to substantial changes in the basic components of any tax: tax rates and the taxable base. With regard to the first of these components, the tendency is to make substantial reductions in the marginal rates, while seeking to maintain the average rates, which determine the level of the tax burden. The central idea is that it is the marginal rates which affect the behaviour of the economic agents, so these rates must be reduced if neutrality is to be achieved.

With regard to the second component—the taxable base—the aim is to expand it, and this brings in the concept of horizontal equity: if two individuals are in a similar situation, then they should pay the same amount of taxes. This aim of horizontal equity, which has tended to displace the previous aim of

vertical equity, is achieved insofar as tax legislation treats equal persons equally. The expected result is the expansion of the taxable base. Together, reduction of the marginal tax rates and expansion of the taxable base maintain the average level of taxation needed to finance public expenditure.

This movement towards efficiency in the tax system is applied to all the components of the tax structure. In the value added tax, through its generalized application; in income tax, through expansion of the taxable base and reduction of marginal tax rates; and in import duties, through the unification of tariffs. As the whole debate moves in the same direction, the tax policy recommendations arising out of it are integrated and coherent with each other.

But why should these considerations seem important to us? In general, for two main reasons. The first of these reasons is because one way or another they form the collection of ideas on which the analysis of this question is based in our countries, even though their content is often distorted or they are used out of context, overlooking essential differences. The most important reason, however, is quite different and is connected with the processes of globalization and economic openness. In order to illustrate this idea, it might be useful to draw an analogy with the international technological frontier. In the case of taxation, the countries of the region are behind that frontier, but globalization and economic openness are pushing them towards it and at the same time preventing them from departing from its fundamental principles.

2. The reforms in Latin America

The 1980s were also a very active period as regards tax reforms in Latin America, too (Carciofi, Cetrángolo and Barris, 1994). These reforms took place, however, within a macroeconomic context dominated by the dynamics of the external adjustment and the internal stabilization programmes, so that they were aimed mainly at maximizing tax revenue in order to help achieve those two objectives. Nevertheless, the real tax burden remained more or less constant during this period, so that governments had to resort to other ways of covering the fiscal deficit.

In most cases, the main feature of the reforms was the generalized application of the value added tax, at a single rate or at a very small number of different rates. The design of income tax systems changed radically compared with the past, through the elimination of some tax incentives, better methods for indexing the taxable bases, and reductions in the marginal and average rates. Altogether, the changes were designed to simplify the system in order to facilitate tax administration and reduce evasion: objectives in keeping with the fundamental need to recover the tax collection capacity. The progress made by some countries of the region in this field is quite noteworthy.

The question of vertical equity, which had been the central objective in previous decades, no longer figures on the agenda of the recent reforms. On the basis of indirect indicators, it may be conjectured that even in the best cases the incidence of taxes has not become more progressive, and most probably its regressiveness has increased during this period.

The policy recipes currently prevailing in fiscal matters in the region recognize the need for greater progressiveness but also favour a special way of achieving this (Tanzi, 1992). This method gives priority to the tax collection objective of tax policy and to its neutrality. The task of giving fiscal policy greater progressiveness is left mainly to the reorientation of public expenditure, because it is considered that progressiveness stems from the net impact of government action as a whole on the different social groups, both on the income and the expenditure side.

This is not convincing, for two reasons. One is the distance separating the countries of the region from the international frontier of tax practices referred to earlier. The other is the enormous inequalities observed in the region with regard to the distribution of income and wealth. Both these factors

point to the need to do more with regard to the objective of vertical equity in the field of taxation.

It is therefore necessary to make a critical review of the way the region has tackled this task in the past and to avoid introducing distortions and conflicts with the other objectives of tax policy. The situation could be considerably improved by using a limited set of instruments acting both on indirect and direct taxes and, above all, by giving the necessary priority to soundly-based development of the tax administration system.²

With regard to indirect taxation, consideration should be given in each country to the objective of introducing a simple but not uniform structure of the value added tax, together with some special-purpose taxes on particular types of goods (Carciofi and Cetrángolo, 1994). Within such a scheme, the value added tax would provide a broad tax collection base, while the special purpose taxes would permit differentiated forms of taxation on a subgroup of goods which are not consumed in a uniform manner in the different social strata.

In order to make progress with regard to vertical equity, however, it is also necessary to take action on the very low yields of direct taxes; it is worth noting in this connection that the average yields in this respect for the countries of the region as a whole are 10 percentage points of GDP below those obtained in the member countries of the Organization for Economic Cooperation and Development (OECD), after discounting the differences between the social security systems of the two groups of countries.³ Although there is some room for improvement with regard to local taxes, the main responsibility for this unsatisfactory performance must be borne by income tax.

² Improving the system of tax administration is essential in order to reduce tax evasion, which stands at a very high level in almost all the countries of the region. Otherwise, relatively low tax burdens can give rise to a high degree of tax pressure on those who actually fulfill their tax obligations.

³ In seven OECD countries, the simple average of direct taxation as a percentage of GDP is 14%, with a maximum of 24% (Sweden) and a minimum of 8% (France). In thirteen Latin American countries, in contrast, the simple average for the same variable is only 3%, with a maximum of 5% (Mexico) and a minimum of 1% (Bolivia). The difference between the two groups of countries, although still considerable, is much smaller with regard to the respective total tax burdens, likewise as a percentage of GDP: a simple average of 27% in the OECD countries and an average of 14% in the Latin American countries. This is a clear indicator of the bias against direct taxation in Latin America (see ECLAC, 1992, table IV-3).

In past decades, redistribution through taxation was centered on excessive refinements in this tax. This strategy failed to work for various reasons: high and recurrent inflation, weakness of the tax administration system, and the pursuit of too many objectives through a single instrument, to name only a few. A simple design of income tax, following the patterns used in the developed countries, together with sustained progress in tax administration, would make

it possible to carry out this outstanding task successfully in the region.

The potential advances in equity that could be obtained through taxation do not, of course, remove the need to make considerable improvements in the allocation of expenditure: a question which will be dealt with in the following section. In reality, these two dimensions mutually condition and legitimize each other.

IV

Equity and public expenditure: how much room for action is there?

When the need to give priority to the objective of greater equity is mentioned, attention tends to be focused on public expenditure, for good reason. In most countries, there is a good deal of leeway in this field for improvements in priorities and in the replacement and productivity of expenditure. In order to take advantage of this leeway, it is necessary to link the objective of equity with the other objectives of public policy and the same time to give priority to the use of the resource allocation instruments already established institutionally.

The government's capacity to realize its objectives depends on the resources at its disposal, but also on the instruments available to it. One of the areas where most can be done to increase the efficacy, efficiency and economic rationality of government action is the system for the programming, budgeting and management of public resources. The hub of this system, because of its legal and institutional status, is the public budget, and a small digression is called for in this respect.

Unfortunately, the fiscal dimension of the external crisis of the 1980s led to the collapse—to a greater or lesser extent, depending on the countries—of the institutional capacity to operate such a system effectively (Martin and Guijarro, eds., 1989). In a number of cases, public budgets came to be the result of the prevailing circumstances rather than a programming exercise. In some cases, there was an almost total loss of budgetary culture and a breakdown in institutional relations, which was reflected in various dimensions: between global-level bodies and those

responsible for executing the expenditure; between the economic and the monetary authorities, and between the Executive and the Legislature.

1. Changes in the system of financial administration

In recent years, a number of governments in the region have been making great efforts to reconstruct and modernize this system (Martin, 1992). In their initial stages, these efforts have been aimed at solving the shortcomings observed in the short term, controlling the financial dimension of expenditure, and restoring the full application of the budgetary cycle. Fulfillment of these stages is undoubtedly essential, and important achievements have been made in this respect in a number of cases.

One of the novel aspects of the reforms undertaken is the linking together of the phases of budget formulation, execution and control through new integrated systems of financial management which cover accounting aspects, treasury and public credit management, staff and supply management, budgetary operations and follow-up and control (ASIP/ILPES, 1994). These new systems, further enhanced through modern computational facilities, free staff from routine tasks and allow them to devote their attention to matters of a more analytical nature.

Mention may also be made of the very positive tendency to introduce budgetary classification systems which make possible objective-oriented management and the preparation of indicators and

systems for the physical and economic follow-up of the different expenditure programmes, together with relatively more highly developed controls over financial execution.

This trend should be consolidated and extended to the executing agencies themselves, which, on the basis of rules of a general nature and with the corresponding technical support, will bear primary responsibility for putting it into effect. The task is no less important from an institutional point of view: there is a great deal of inertia to overcome; it is necessary to define and establish means of dialogue and coordination, and above all, it is necessary to insure that information—which is not exactly a free good—flows properly throughout the management system.

In addition, it is necessary to improve the institutional capacity to define sectoral policies—and in some cases also multi-sectoral policies—as a framework for the formulation of technically sound programmes and projects, since the basic element for good global resource allocation is the technical quality of the expenditure proposals.

It seems obvious that if this is not done, the public budget can hardly be anything but a rigid instrument governed by inertia and by bureaucratic and political compromises, without any real foundation. Upward or downward adjustments can only lead to a final financial position which affects everyone equally, without being based on the priorities or merits of the different expenditure programmes, for the simple reason that they are not sufficiently known.

The challenge is therefore very considerable. The task extends to almost all the bodies in the public sector, but especially those responsible for social policy. The traditional weaknesses—heightened by the impact of the crisis of the 1980s on the State apparatus—are to be seen at various important levels, including the low level of capacity to formulate policy guidelines which are sufficiently soundly based and adapted to budgetary constraints, to design effective programmes, to suggest corrective action on the basis of assessments of the operations underway, and to provide timely and reliable information.

2. The budget as an instrument of government management

When an effort is made to give priority to equity, or indeed to any other government objective, it is necessary to have a budget through which it is possible to

visualize the opportunities, exercise the available options, and have real alternatives for action. The possibility of redirecting expenditure is not always limited by the available resources; sometimes, the restriction is due to the lack of good programmes or to serious shortcomings in the implementation capacity of the executing agencies.

A system which does not provide for any kind of substantive assessment and which is unaware of the impact of government actions on the target population will undoubtedly lead, because of the existence of various kinds of leakages, to poor yields from the very substantial resources currently allocated to the social field. In a number of countries, there is growing concern over the fact that only a small part of each unit of account allocated to social expenditure actually reaches its direct target beneficiaries. In order to tackle this situation, some of the procedures already used in developed countries could be used, such as periodic external assessments of the performance of various areas of government, leading to revisions in their budgets.

So far, we have given priority to questions of a technical nature in our discussion of the relationship between the budget and equity. This does not mean, of course, that we are ignoring the fact that the budgetary process also involves a good deal of political and institutional negotiation. While it is true that the complex process through which political decisions are taken cannot be replaced by mere technical calculations, it should also be clearly understood that the necessary political decisions can gain greater efficiency and global rationality if they are taken in the light of a sound and transparent technical base.

This need for transparency should be given particular emphasis when assessing the public budget. The budget is one of the main instruments for action by the Executive, but it is subject to an interactive review in conjunction with the Parliament, that is to say, with the political representatives of the public at large, and sometimes it is also subject to other forms of public revision too. These processes will of course be of little use if the budget is unclear, its format is unfriendly to the potential user, and it is a real puzzle to decipher. Sometimes, it is not possible to obtain an answer to such elementary questions as how much is going to be allocated in a particular year to education, because it is necessary to pass first of all through a maze of budget appropriations. This conspires against the possibility of making the budget

into a means of clearly expressing the available options and ensuring that expenditure decisions support the real objectives of the government and of the political forces represented in Parliament.

Finally, it should be emphasized that budgetary reforms integrated with the rest of the State financial management subsystems, such as the introduction of objective-oriented management, with well-designed programmes, the development of economic and financial follow-up systems, the incorporation of mechanisms for assessment of results, and the classification of activities by major expenditure policies, in

order to increase transparency, are all necessary conditions for improving the budgetary process and thus taking advantage of the room available within the expenditure structure for achieving greater equity.

Unfortunately, although these conditions are very necessary they are not of themselves sufficient. It is also necessary to place the budgetary debate within a pluriannual framework of income and expenditure projections, in line with the evolution of the macroeconomic situation and development policies. These matters will be dealt with in the last section of this article.

V

Growth and equity: how can we ensure their dynamic consistency?

The current approaches to the correction of fiscal imbalances place the emphasis on ways of financing the public deficit—in the light of their different macroeconomic repercussions—and on the evolution of the public debt, recognizing the need for a fiscal policy which is sustainable in the medium and long term.

1. The macroeconomic environment of the budget

It is worth recalling that the budget has two components. One is fiscal policy, which is expressed in the form of a certain combination of fiscal aggregates programmed on the basis of the macroeconomic goals that the government hopes to achieve with the aid of the public finances. The other component is of a conjunctural nature, since the budget is subject to exogenous influences which are reflected, at the stage of its formulation, in the adoption of assumptions and estimates regarding important events which are expected to take place during the year.

A central task in the preparation of the budget is the combination of these two components in such a way that the macroeconomic objectives fit in with the assumptions and estimates adopted. This consistency must stem from the mutual compatibility of the fiscal, monetary and exchange-rate programmes and from the correspondence between the income and expenditure projections of the various institutional sectors.

It very frequently happens that the effective behaviour of the economy and of the exogenous variables affecting it differ significantly from the assumptions used in preparing the budget. In this case, the dilemma facing the government is whether it should reformulate the budget components to make them fit in with the initial macroeconomic objectives or whether it should adjust the latter to take account of the problems which have arisen.

Annual budgetary cycles form an excessively restrictive strait-jacket for dealing with this dilemma. On the one hand, they provide little information about the viability and sustainability of particular forms of evolution of the fiscal aggregates, while on the other they make it more difficult to exercise policy options calling for the definition of lines of action within a medium-term horizon.

For this reason, governments increasingly tend to place their annual budgetary exercises within a pluriannual framework which makes it possible to analyse the projected evolution of the fiscal aggregates and their repercussions within the macroeconomic context. This is not aimed, of course, at conditioning future budgetary activity in a rigid manner, but at providing a flexible instrument which will make it possible to take account of medium-term objectives and pay special attention to the requirements of an economic situation which is constantly changing and is only partly under the control of the government.

In its microeconomic dimension, the budget displays a fundamental imbalance in its composition. Whereas on the income side it only contains an estimate based on assumptions regarding the behaviour of the tax base and public prices during the year, on the expenditure side it contains commitments which, even when not subject to legal obligations, are difficult to change in the course of the year. The adoption of a pluriannual programming framework also aims to handle this fundamental imbalance.

On the income side, the budget makes it possible to distinguish between transitory effects and the more or less permanent levels of each of its components. The deterioration of the budget as a fiscal policy instrument is not due to the fact that the *ex post* fiscal aggregates do not coincide with the assumptions made, which is only normal, since public income depends on tax bases and prices whose evolution is uncertain. The real problem arises when transitory factors lead to decisions which affect permanent aspects of the budget in a manner which has no relation with the medium-term macroeconomic prospects and objectives.

On the expenditure side, it is well known that in any budget year the expenditure committed in previous budgetary exercises amounts to at least 70% or 80% of current income. Consequently, the leeway for reallocating expenditure in an annual budgetary cycle is very limited and, what is worse, such reallocation may be costly for public management. In this case, the adoption of a pluriannual framework facilitates a gradual move from one expenditure programme to another, in response to changes in government priorities.

In short, the need to produce information on future developments which makes it desirable to establish a pluriannual framework favours the unity and inter-temporal coherence of the public decision-making process. In particular, it makes possible a form of fiscal management which tends to impart structural soundness to public income and to make the expenditure side of the budget more flexible, so that the public sector's financing needs are compatible with the real resources at its disposal.

Thus, it can make a decisive contribution to fiscal governance, understood as the government's capacity to carry out its fiscal policy in a manner which is both sustainable and credible and which involves the least possible costs in terms of the efficacy of public management (Marcel, 1993). The reason for

this is not exclusively technical: producing information on the future seeks to make the actors involved in the budgetary process aware of the dilemmas of public financial administration. This can significantly help in generating a favourable climate for fiscal discipline and the achievement of specific political agreements for carrying out a sustainable fiscal policy, by reducing the shortsightedness caused by the conjunctural factors affecting the budget and the fiscal aggregates.

With these elements it is possible to give a positive answer to the question posed in the title of this section: placing the budget within a pluriannual fiscal programming framework is a suitable means for permitting the consistent evolution of growth and equity: that is to say, facilitating its dynamic consistency.

2. Growth and distribution: a thorny dilemma

As everyone knows, while a growing economy makes possible greater advances in terms of social equity, these are by no means automatic. Indeed, in some countries of the region there have been periods of growth which have been accompanied by a deterioration in social equity. The usual answer given to explain this inconsistency is that a period of sustained growth is needed before distribution can improve. This assertion is repeatedly made as an *ex ante* argument, but it is hardly ever explained afterwards why this expected consequence did not take place.

Likewise, there have also been cases in the region where the opposite has taken place: that is to say, policies aimed at producing immediate effects in terms of distribution have resulted, sooner rather than later, in setbacks in this respect, in the midst of serious macroeconomic imbalances and rapid exhaustion of reactivating growth.⁴

In the first case, the stabilization and recovery of growth achieved are not sufficient to induce a process of saving and investment which will make sustained growth viable; moreover, the passivity with which the question of distribution is viewed means that it is always put off for another time. In the second case,

⁴ It is generally assumed that the inflation tax has regressive distributive effects. In the case of Argentina, the estimates available for the 1980-1990 period confirm this assumption: the average burden borne in that period by the poorest quintile (8.6% of their income) was almost three times greater than that borne by the richest quintile (3.0%). See Argentina, Ministerio de Economía y Obras y Servicios Públicos, 1992, table 5, p. 14.

advantage is taken of a favourable economic and financial conjuncture to apply policies which are not sustainable except under the exceptional conditions of a succession of favourable events, which of course is inevitably interrupted sooner or later.

How can fiscal policy help to overcome this thorny dilemma in which the economies of the region seem to be trapped? First of all, it is necessary to adopt active fiscal policies on both the income and the expenditure side, focussed through public inter-

vention in the social sectors, as noted in previous sections. Secondly, fiscal policy must be prevented from becoming a mere passive sounding box for the economic cycle and external disturbances. In both cases, pluriannual budgeting exercises, backed up by other available instruments (Martner, 1996), can help to promote a succession of non-traumatic public decisions in this respect, while providing greater assurance that the set of actions in question is sustainable in the medium and long term.

VI

Final comments

By way of conclusion, we may recall the questions on which this article was based, after which we will make some brief final comments. Those questions were the following: what is the real meaning of the concept of equity? Is there room in the field of taxation for the expansion of resources and the improvement of vertical equity? What means should be used for giving priority in public expenditure management to the objective of equity? Can there be dynamic consistency between growth and equity?

The comments we wish to make are the following: first, the redistributive function of fiscal policy must be made compatible with the functions of allocation and stabilization, since they interact to a significant degree in the areas of both public income and expenditure. This means that they must be considered simultaneously.

Second, it is essential to restore a medium-term horizon in public finances, since in this way it is possible to find room to accommodate social needs and to link together the government action to satisfy them, while expressly taking account of the need for sustainability.

Third, giving priority to the aim of social equity is a political decision of the greatest magnitude whose achievement must be actively pursued through specific measures, in a serious, sustainable and coherent effort. In order for this decision to be more than just empty words or to avoid degenerating into clientage, it must be applied to the social sphere as a whole, while explicitly establishing the relevant priorities. And in order to avoid the danger of it being frustrated, it must be based on operational procedures which combine social participation with the creative and judicious use of public policy instruments.

(Original: Spanish.)

Bibliography

- Argentina, Ministerio de Economía y Obras y Servicios Públicos (1992): *Argentina en crecimiento*, Buenos Aires.
- ASIP (Asociación Interamericana e Ibérica de Presupuesto Público)/ILPES (Latin American and Caribbean Institute for Economic and Social Planning) (1994): *Informe de relatoría. Taller sobre sistemas integrados de administración financiera*, LC/IP/R. 152, Santiago, Chile, ILPES/ECLAC, Consejo Regional de Planificación, 24 November.
- Atkinson, A.B. (1989): Poverty, J. Eatwell, M. Milgate and P. Newman (eds.), *Social Economics. The New Palgrave*, London, Macmillan Press.
- Carciofi, R. and L. A. Beccaria (1995): *Provisión y regulación pública en los sectores sociales: lecciones de la experiencia latinoamericana en la década del ochenta*, Santafé de Bogotá, UNICEF Libros.
- Carciofi, R. and O. Cetrángolo (1994): *Tax Reforms and Equity in Latin America: A Review of the 1980's and Proposals for the 1990's*, Innocenti Occasional

- Papers. Economic Policy Series, No. 39, Florence, Italy, United Nations Children's Fund (UNICEF), International Child Development Centre.
- Carciofi, R., O. Cetrángolo and G. Barris (1994): *Reformas tributarias en América Latina: análisis de experiencias durante la década de los años ochenta*, Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC)/S.R.V. Impresos.
- ECLAC (1990): *Changing Production Patterns with Social Equity*, LC/G.1601-P, Santiago, Chile. United Nations publication, Sales No. E.90.II.G.6.
- (1992): *Social Equity and Changing Production Patterns: An Integrated Approach*, LC/G.1701/Rev.1-P, Santiago, Chile, August. United Nations publication, Sales No. E.92.II.G.5.
- Gómez, J. C (1991): Orientaciones en materia de reforma tributaria, *Colección conferencias*, Buenos Aires, Fundación Omega Seguros, December.
- Marcel, M. (1993): *Gobernabilidad fiscal, presupuestos y finanzas públicas: un estudio a partir de la experiencia chilena*, Washington, D. C., Inter-American Development Bank (IDB), mimeo.
- Martin, J. (1992): *Los nuevos retos en la programación del sector público*, LC/IP/L.052, Santiago, Chile, ILPES.
- (1994): *La política económica en la poscrisis y el proceso de reforma del Estado*, LC/IP/R.150, Santiago, Chile, ILPES.
- Martin, J. and A. Núñez del Prado (1993): Strategic management, planning and budgets, *CEPAL Review*, No. 49, LC/G.1757-P, Santiago, Chile, ECLAC.
- Martin, J. and M. Guijarro (eds.) (1989): Introducción general de los compiladores, *Finanzas públicas y desarrollo. Coloquio Franco-Latinoamericano*, Buenos Aires, Grupo Editor Latinoamericano.
- Martner, R. (1996): Indicators of fiscal policy: Design and applications for Chile, *CEPAL Review*, No. 58, LC/G.1916-P, Santiago, Chile, ECLAC.
- Tanzi, V. (1992): Fiscal policy and economic reconstruction in Latin America, *World Development*, vol. 20, No. 5, Oxford, U. K., Pergamon Press.