

## COMMENTS

### **“CHANGING REVENUE ASSIGNMENTS IN LATIN AMERICA” BY EHTISHAM AHMAD AND GIORGIO BROSIO**

**AND**

### **“CENTRALIZATION, INTERGOVERNMENTAL STRUCTURE AND REFORM IN THE MIDDLE EAST AND NORTH AFRICA REGION” BY MEHMET S. TOSUN AND SERDAR YILMAZ**

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I AM GLAD TO BE PART OF THIS PANEL AND I THANK the NTA and the session organizers for having invited me. I have enjoyed reading both papers which, I think, fit together very well, and I am going to base my remarks on some of the issues that they raise.

I will start with the paper on Latin America, which in my modest opinion reads as a precautionary note for the Middle East and North Africa region.

Correctly so, the paper by Ehtisham Ahmad and Giorgio Brosio highlights a decentralization pattern that is, unfortunately, observed not only in Latin America but also in other parts of the world. I would describe such pattern by saying that the decentralization of public spending has occurred in many countries in a faster and disproportionate way when compared with the decentralization of revenues.

Whether it was due to political pressures to decentralize, historical patterns, or other growth-related legitimate objectives, the two sides of the budget constraint equation have not been considered simultaneously, and have not evolved in parallel. This lack of fiscal coherence has always resulted in the detriment of public revenues and fiscal stability.

Not surprisingly, failure to assess the capacities of subnational and local governments to spend and collect, and be fiscally responsible, has resulted into the uneven and dysfunctional decentralization models that we see today, as described in the Latin America paper.

The authors suggest some solutions to improve the revenue capacity of subnational governments at the tax design level. For example, they recommend implementing a subnational VAT in the

short term and improving PIT collections in the longer term. I find such recommendations well conceived and useful; at the same time, given the constraints that they mention in the paper, I remain skeptical about how much can be accomplished in that direction. The main reason is perhaps the weak institutional capacities of those countries to implement more complex systems of taxation.

However, I find their recommendations very useful particularly for policy makers from developing countries. I am in complete agreement with their assessment and suggestions.

Perhaps the only thing that I would add is that it is necessary to see what types of reforms can be undertaken on the spending side of the equation, as well as in the transfer/equalization grants system. By doing so, the reform pressure would be not only on the tax system, which, as we know, is becoming politically more and more difficult as subnational governments claim more autonomy.

Part of the reform side on the spending, which is also not easy at all to implement, may however be accomplished through fiscal responsibility laws (like for example in Brazil). Even if it sounds as a contradiction since it could be interpreted as a push for centralization, a reinforcement of the central government fiscal authority to keep the strategic focus of the country's public spending program.

With this in mind, I now turn to the paper on the Middle East and North Africa region (MNA) by my Serdar Yilmaz and Mehmet S. Tosun. I appreciate the efforts of the authors to capture historical facts and undertake rigorous empirical work. I have four main comments about the paper.

The first one is that given the experience of Latin American countries and other parts of the

world with dysfunctional decentralization models, I would be very cautious recommending decentralization per se in the MNA region. In general the literature and the country evidence so far do not help to make a good case explaining the negative consequences of rather centralized public finance models on public finance management, macroeconomic stability, and growth. The opposite is also true. We find weak evidence in favor of decentralization to promote macroeconomic stability and growth.

Second, since the MNA region does not have historical patterns of decentralization, if one day decentralization does start to pick up speed, it may be for other reasons rather than political or historical; in a way, the fact that such pressure does not exist may be very healthy for the region.

Third, exploring the potential for subnational revenue mobilization should be undertaken before putting in place any spending decentralization mechanism.

My fourth comment is rather methodological. The authors chose the ratio of central government spending to GDP as the dependant variable that reflects the level of centralization of public spending. My interpretation is a bit different. For me such ratio reflects the size of the general government (which in some of the MNA region also means the central government) and nothing else.

Except for some cases like Indonesia, in most countries where decentralization has been unfolding for several years with some clear patterns of subnational and local spending, the ratio of central government to GDP continues to reflect

the majority of public spending in the country, and the one that shows the closest connection to macroeconomic stability and growth. In fact, when it comes to country comparisons, many countries report just central government spending and not subnational spending, because it is difficult to track it down; others report just central government spending knowing that it includes some subnational spending.

Since my interpretation of the dependent variable is different, I also perceive differently the regression results: for example, improvements in the democratic environment in the region may help reduce the size of the government but not necessarily lead to decentralization unless other factors are present. Similarly, reducing external conflicts would lead to having smaller governments but not necessarily more decentralized.

However, I totally agree with the recommendations on the last pages that suggest restructuring the overall fiscal system, exploring private sector participation in service delivery, rationalizing the transfer system, and improving the credibility of the central government to enforce the hard budget constraint. If these reforms are undertaken before the decentralization train gains speed on the expenditure side, perhaps some of the problems of Latin America can be avoided in the MNA region.

Finally, thinking of the road ahead, perhaps the authors should analyze first the impact of current fiscal centralization patterns on macroeconomic stability and growth in the MNA region before deciding about future decentralization strategies.