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The Central Bank of Barbados Book Review Series seek to highlight publications which offer useful insights and analysis on topics related to finance, economic development, and other issues relevant to small island developing economies. The views expressed are those of the author(s) and do not necessarily represent those of the Central Bank of Barbados.

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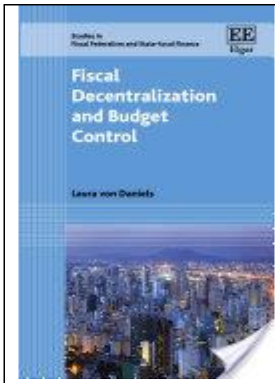
|   | FISCAL DECENTRALISATION AND BUDGET CONTROL |
| | Author: Laura Von Daniels |
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| | Book Review contributed by Nicholas Stapleton |

# FISCAL DECENTRALISATION AND BUDGET CONTROL BY LAURA VON DANIELS

"Fiscal Decentralisation and Budget Control" examines fiscal imbalances, fiscal stabilisation and institutional reforms in Latin America. In a country-by-country assessment, Laura Von Daniels evaluates how different governmental structures impact these fiscal outcomes.

Von Daniels argues that fiscal instability prevents Latin America from achieving macroeconomic stability and recommends institutional reforms as the best solution to improve overall fiscal performance. She attributes fiscal instability to a build-up in budget deficits, caused either by a reduction in tax revenues or increases in the bond market's risk premium payable on public debt. The book reminds us that budget deficits are problematic because they require countries to raise more taxes and they crowd out private sector activity.

The author attributes the spillover effects from the 1994 Mexican crisis to the fiscal imbalances and structural problems in other Latin American countries. She notes that while Brazil, Argentina, Ecuador, and Uruguay reformed government institutions and centralised the management of fiscal matters to achieve fiscal stability, in addition, Ecuador turned to dollarization and Uruguay negotiated a debt exchange with sovereign bondholders.

Argentina and Brazil both faced fiscal crises that originated at the local or subnational level of the respective governments but they managed the challenges differently. Brazil implemented institutional reform to limit the government's expenditure and reduced borrowing requirements. On the other hand, the Argentinian Government's inconsistent budget decisions and lack of transparency weakened fiscal performance. Further, weaknesses in the fiscal and high public debt between 1990 and 2006 reduced foreign capital inflows in Argentina in 2001.

In another case study entitled, "Reforming Budget Institutions in Brazil & Argentina," the author argues that under a central budgetary institution, the central government is better equipped to execute decisions about the fiscal at the local or subnational level.

The book also identifies horizontal and vertical decentralisation, fiscal targets and constraints (hierarchy and delegation) as measures to prevent fiscal instability. Horizontal decentralisation occurs when the central fiscal authority across different line ministries and other public sector enterprises loosens budgetary control. However, the central budget authority controls all of public sector borrowings, especially at the subnational government level. This style of management addresses the market indiscipline evidenced by the recurrent financial crises in Latin America.

In small nations specifically, local governments tend to be closer to the people, as they are more responsive and allow constituents to develop laws and policies that fit their needs. State and local governments manage transportation, law enforcement, and public schools, and they champion environmental protection and health care.

Vertical decentralisation is identified as an important budgetary control because it limits fiscal policies. Vertical decentralization also strengthens fiscal discipline and improves a country's fiscal balance if people demand accountability from their policymakers. Accountability leads to efficiencies and reduces the cost of producing and providing public goods. Local authorities are also more in tune with their people's needs and preferences and they use this knowledge to minimise wastage of public goods and to slash expenditure.

The decentralisation of expenditure and revenue collection must occur at the same time to avoid fiscal indiscipline. Why? Because local governments may increase expenditure with the hope that central government will fund the rising costs (Brennan & Buchanan, 1977), (Brennan & Buchanan, 1980) & (Oates, 1972). Ezcurra & Pose (2010) who conducted a study involving 21 OECD countries and the impact of fiscal decentralization on economic growth, agree that fiscal decentralization depresses economic growth and fiscal indiscipline contributes to higher levels of expenditure and debt.

Moreover, Von Daniels finds that the fiscal imbalances balloon when government structures are fragmented. A study of OECD countries between 1960 and 1985 also confirms that under fragmented government control, several developed countries struggle to reduce high deficits caused by fiscal mismanagement (Roubini & Sachs, 1989b) & (Roubini & Sachs, 1989a).

Countries that use fiscal targets to prioritise expenditure limits achieve greater stability. However, the success of fiscal rules depends on the political system. Von Daniels notes that a majoritarian system supports delegation of fiscal responsibility, while contracts are preferred in proportional representation systems. The author concludes that hierarchy and delegation, contribute to budget stability but the aftermath of implementing more hierarchies and objective fiscal targets are stronger in countries that embrace and promote transparency. Debrun, Eyraud, Hodge, Lledo, Pattillo, & Senhadji (2018) state that better designed fiscal rules can help prioritize the many budget demands, protect public debt and create room in the budget to finance policies that promote growth.

The book "Fiscal Decentralisation and Budget Control" analyses the different approaches to maintain fiscal stability, one of the essential functions of any government. However, in order to achieve fiscal security, countries must strike a balance between stability, allocative efficiency and redistribution.

I recommend this book to both academics and decision makers because it outlines the main policies associated with fiscal instability and the possible strategies that countries can carry out to maintain macroeconomic soundness and fiscal discipline.

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