

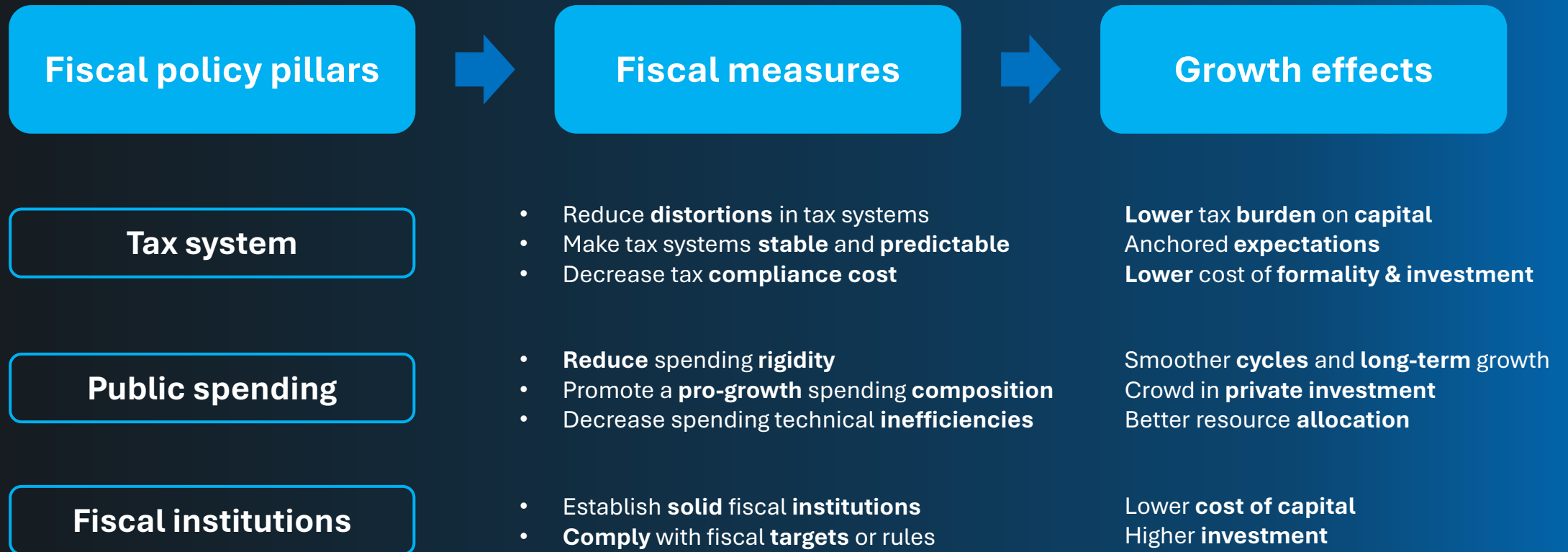


Three pillars for growth-enhancing fiscal policy

Marta Ruiz-Arranz

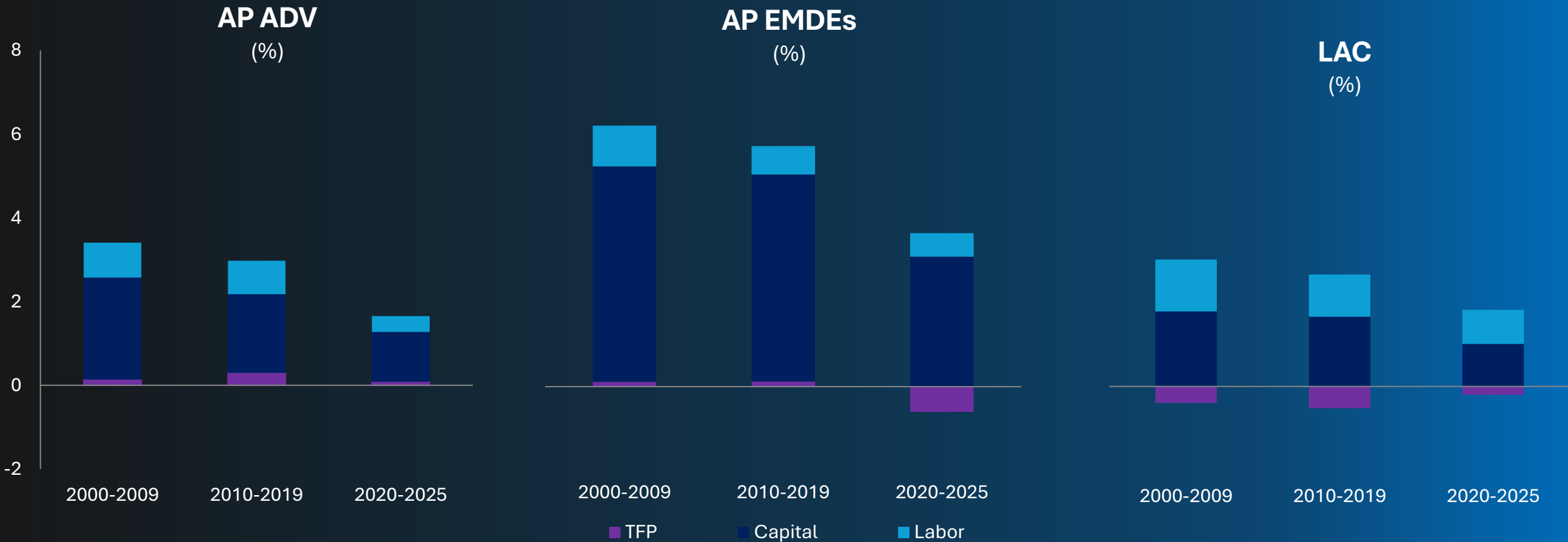
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Inter-American Development Bank
June 2026

Fiscal policy has played a stabilizing role amid recent shocks, but strengthening its growth-enhancing function remains a key policy priority



Economic growth decline across regions is largely explained by lower capital and productivity contributions

Growth accounting decomposition



Is corporate taxation playing a role?

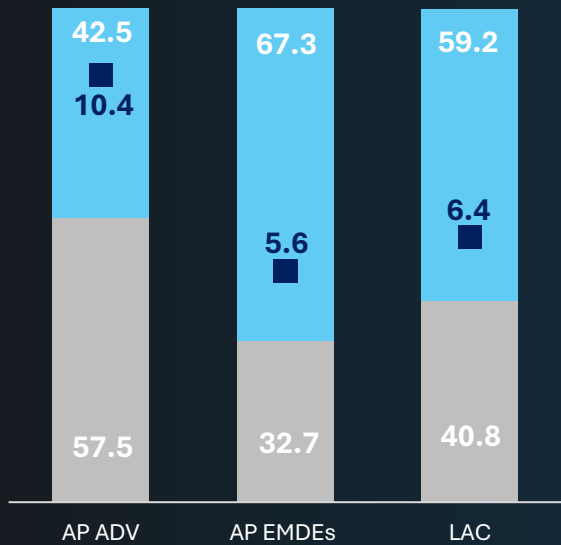
CIT in EMs: high rates, limited revenue, and a bottleneck for doing business

EMs disproportionately tax corporate income compared to individuals

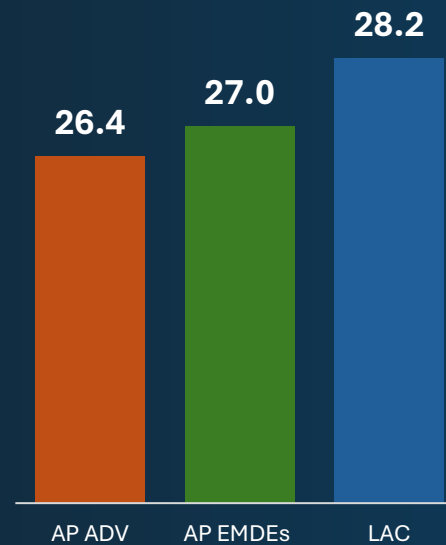
Despite higher tax burdens, emerging markets raise less revenue

Tax rates represent a major or very severe an obstacle in EMs and especially in LAC

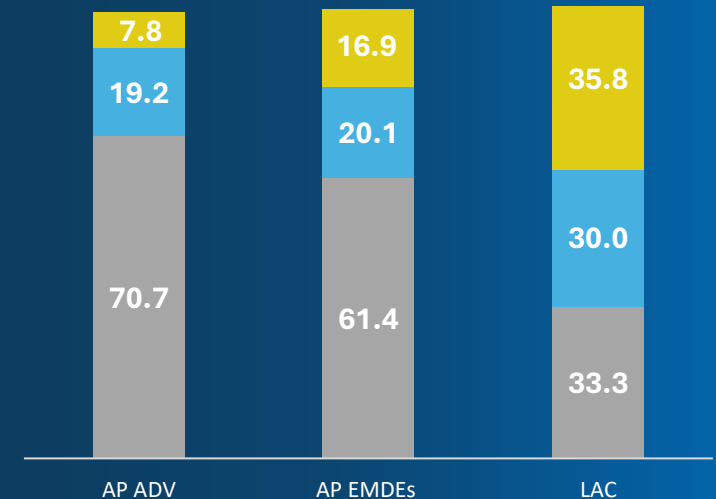
Corporate Income Tax (% total)



Effective corporate tax rate (%)



Tax rate as an obstacle (% firms in each level)

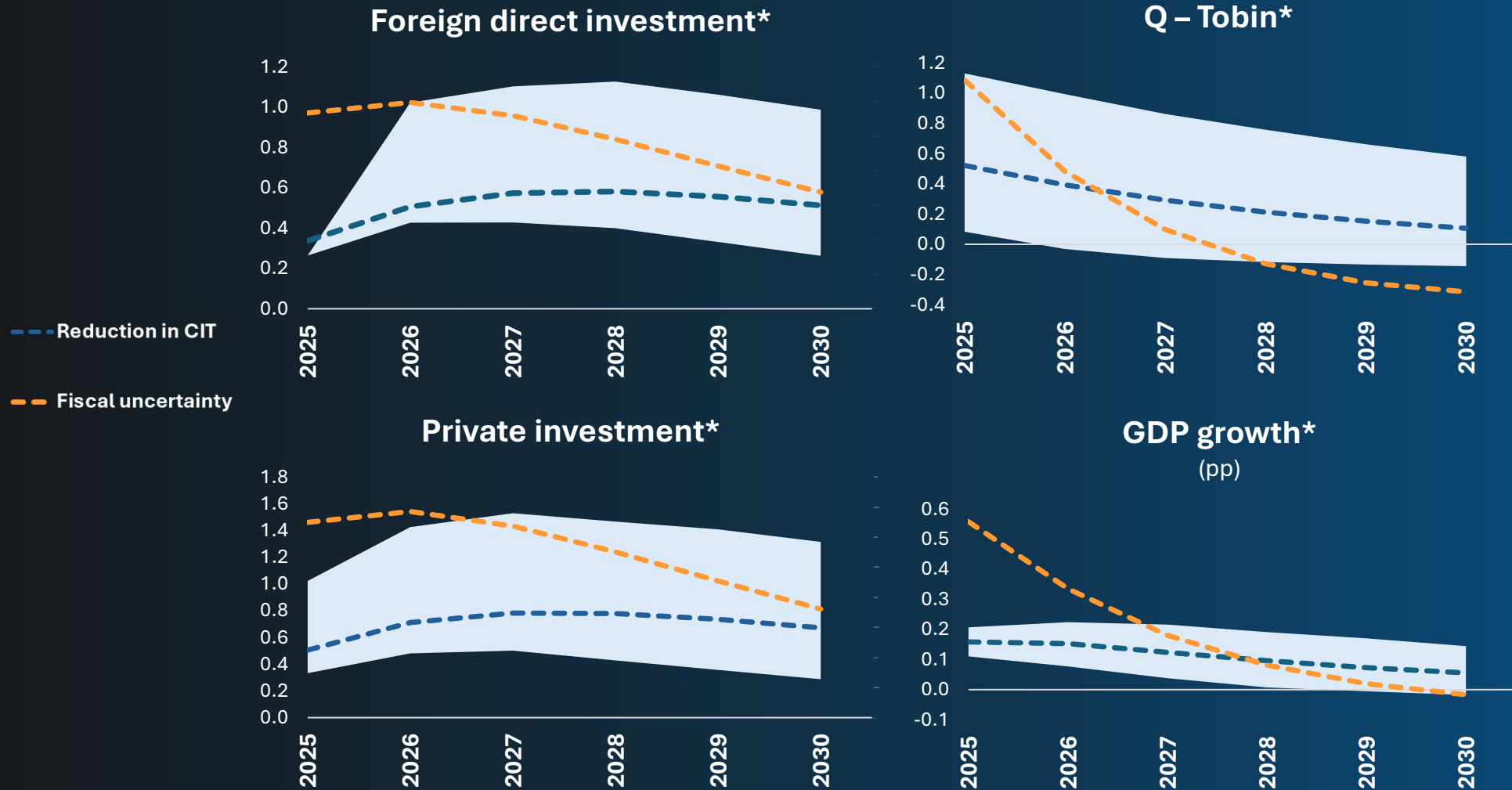


■ Individual income tax ■ Corporate income tax
■ Total (% GDP, right axis)

■ Major or very severe obstacle ■ Moderate obstacle
■ No obstacle or minor

Reducing CIT rates is not an option for many.

Reducing uncertainty about future capital taxes boosts investment and GDP growth



* Deviations from baseline.

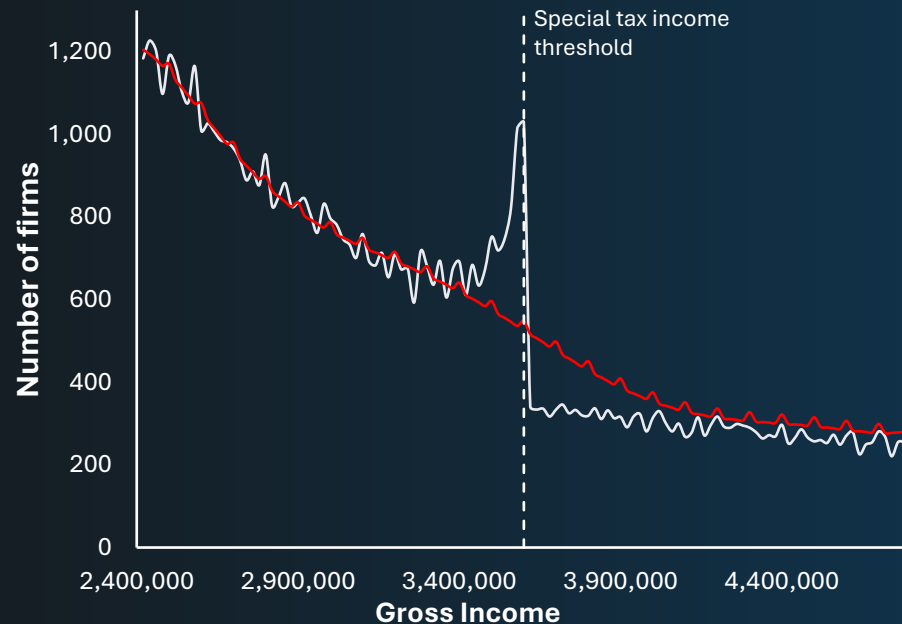
Source: IDB-FMM FISLAC estimates based on data from official sources and the IMF-WEO and based on Fernández-Villaverde et al (2015). Fiscal Volatility Shocks and Economic Activity. American Economic Review. Fiscal uncertainty refers to the volatility of effective tax rates expectations of investing firms.

Not so simple: special regimes for SMEs can hold back productivity

- The cost of **staying small** is lower than the cost of growing (Ruiz-Arranz & Deza, 2018; Levy & Cruces, 2021).
- It creates an **implicit tax on growth**: aggregate output and TFP stay at a suboptimal level (Garicano, Lelarge & Van Reenen 2016).
- Mexico's aggregate TFP **fell** at -0.5% per year over 1998-2018. The special tax regime is identified as one of the main causes (Fentanes & Levy 2024).

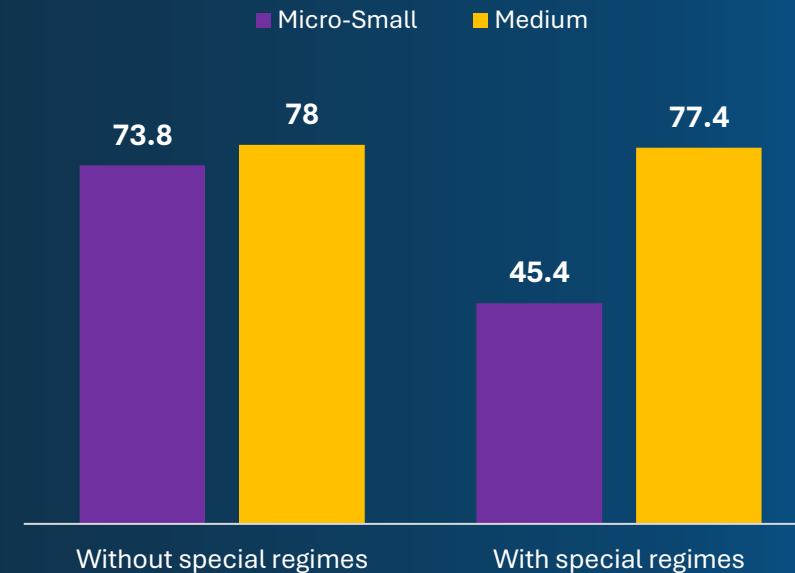
Firms' distribution across income

(Notch=3.600.000, Binwidth = 20000)



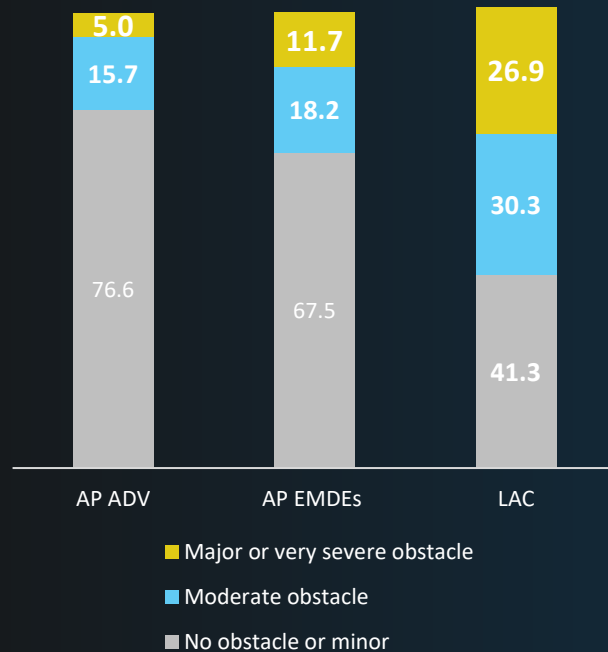
Labor productivity gap depending on special tax regimes

(Large firms productivity = 100)

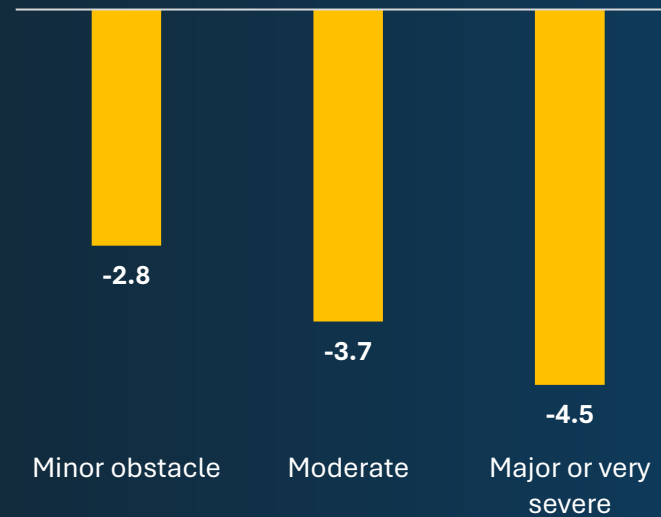


Tax administrative burdens can reduce investment and encourage informality

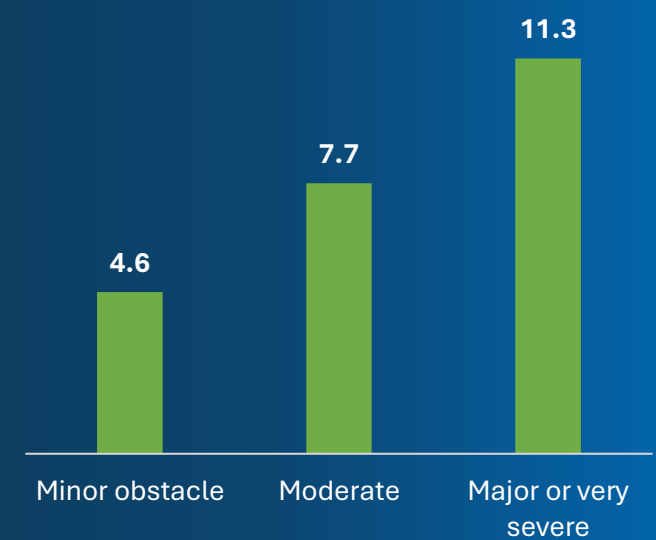
Tax rate as an obstacle
(% firms in each level)



Impact of tax administration as an obstacle on firms' investment plans
(pp, probability)

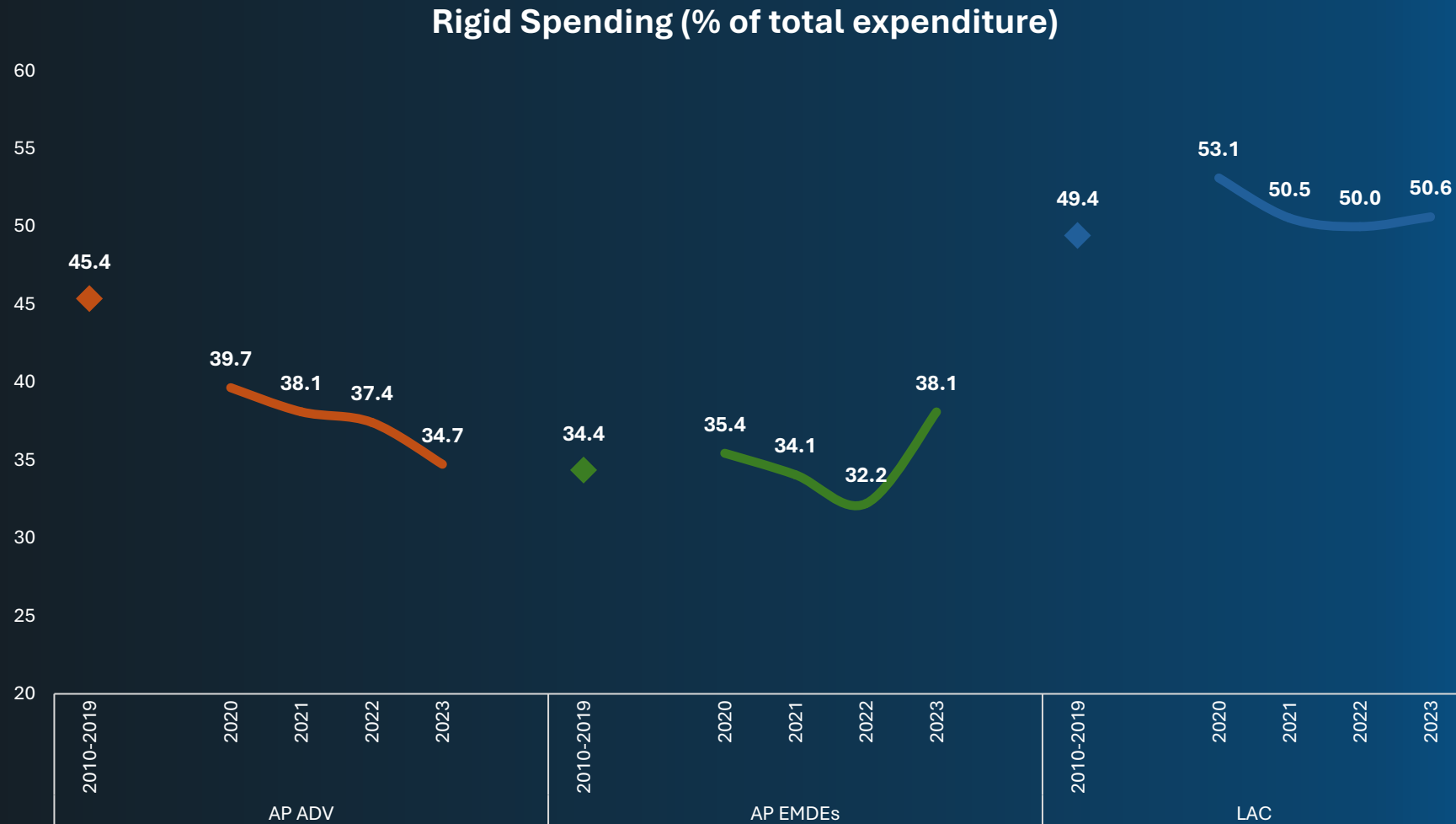


Impact of tax administration as an obstacle on informality
(pp, probability)



Note: IDB-FMM FISLAC calculations using data from the World Bank Enterprise Surveys. The two graphs on the left show the effects of tax administration as an obstacle on the probability of investment, measured by equipment purchases, and on informality. The model is estimated using a pseudo-panel based on firm-level data from the World Bank Enterprise Surveys, covering more than 140 countries between 2000 and 2024, with a sample of around 100,000 firms. Question for investment: Did this establishment purchase equipment in the past year?, Question for informality: Does This Establishment Compete Against Unregistered Or Informal Firms?.

EMs exhibit high and non-decreasing spending rigidity, with implications for growth

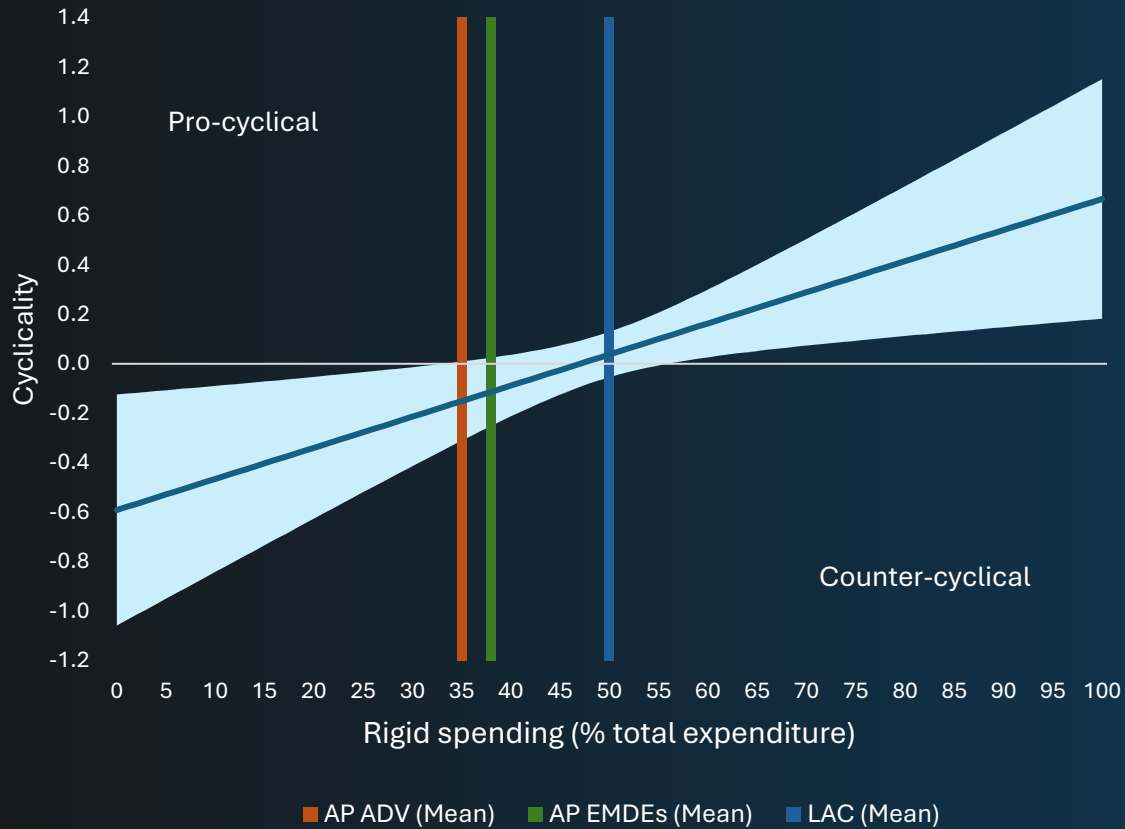


Note: IDB-FMM FISLAC calculations based on GFS-IMF, ECLAC, WEO and WBI. Limited data availability for Asia-Pacific EMDEs pension payments constrains coverage of rigidity measure.

Higher rigidity affects the response of the fiscal policy to the cycle and limit the fiscal space for pro-growth spending

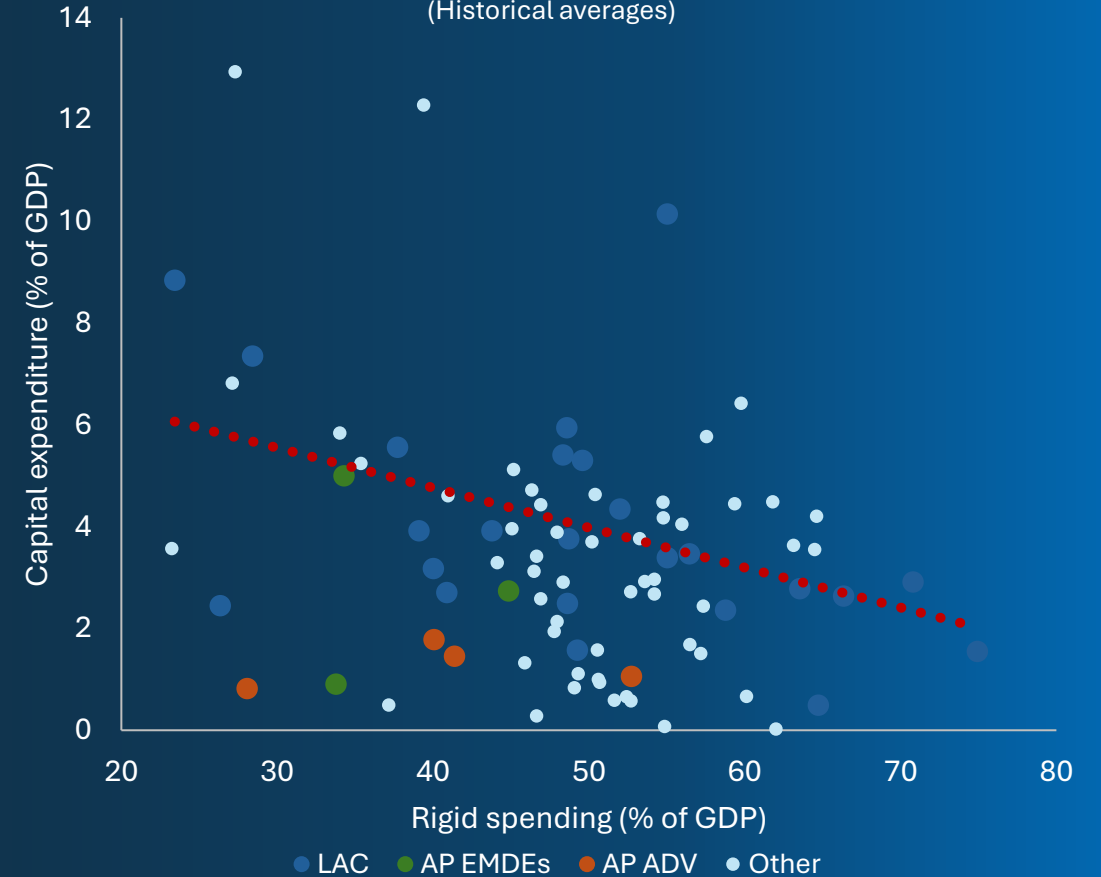
Primary expenditure cyclicality across rigidity distribution

(2023 means)



Capital expenditure and rigidity

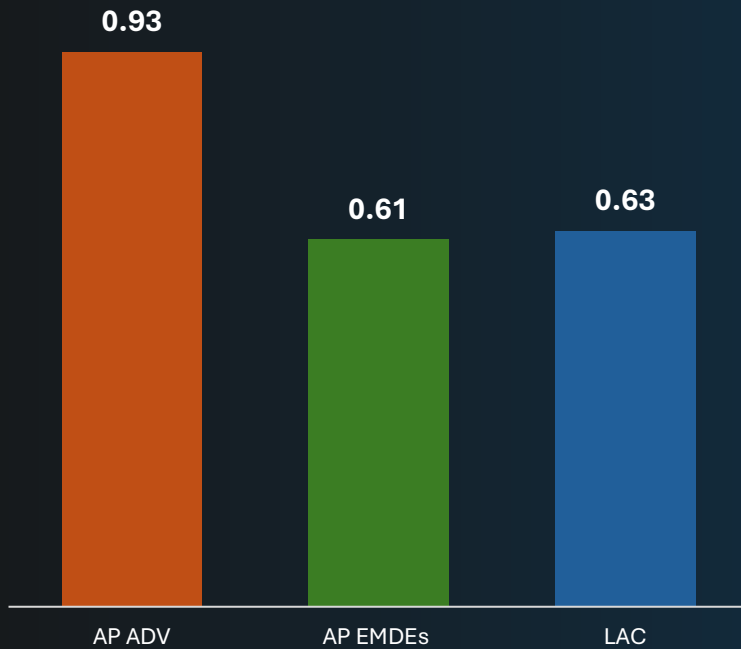
(Historical averages)



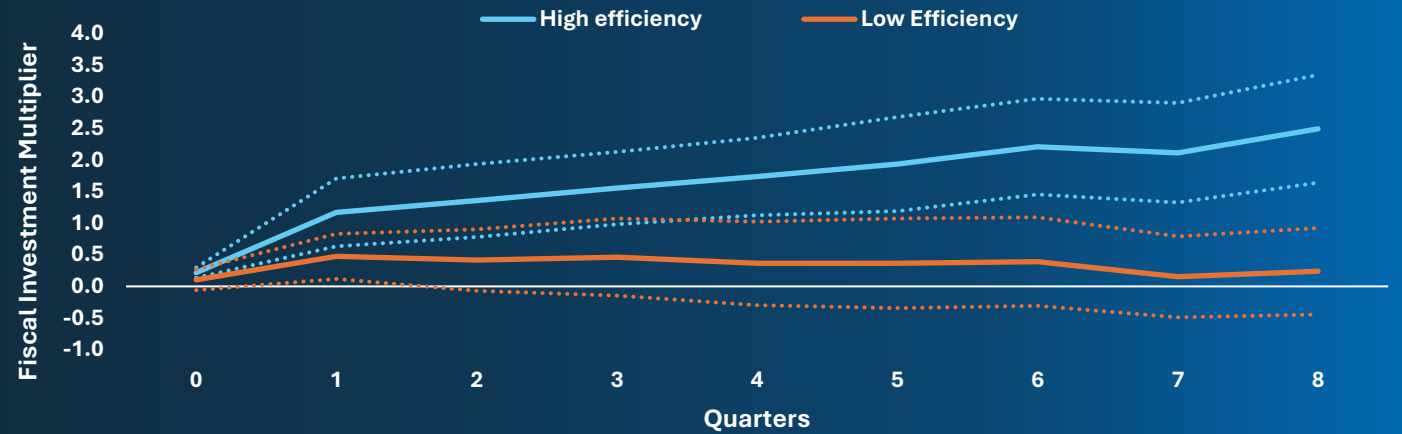
Note: IDB-FMM FISLAC calculations based on GFS-IMF, ECLAC and WBI. Rigid spending measured as the share of wages, interests and pension payments on general government total expenditure. Primary expenditure cyclicality is measured as the percent deviation of primary expenditure from its Hodrick-Prescott trend. Limited data availability for Asia-Pacific EMDEs pension payments constrains coverage of rigidity measure.

Higher efficiency in investment has a significant yield in short-term economic growth

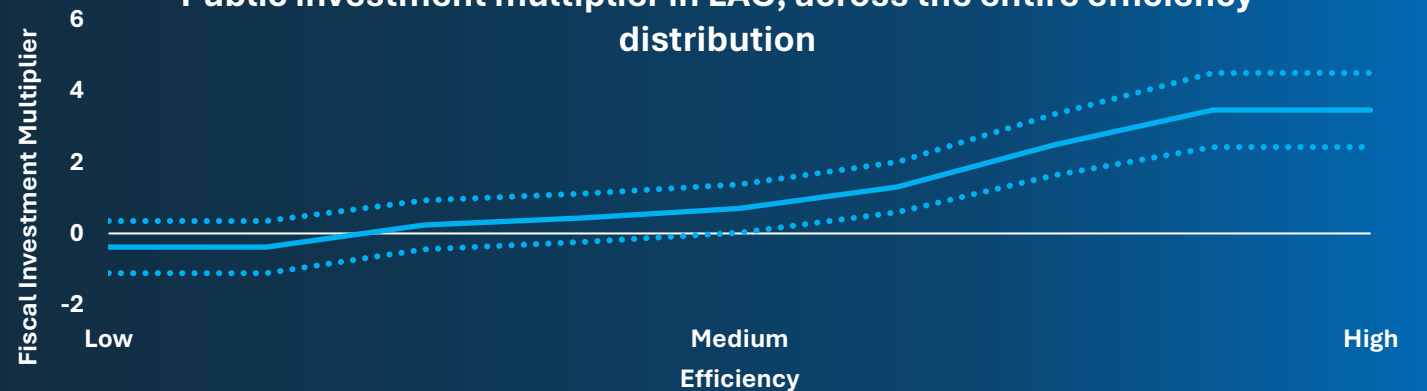
Infrastructure Efficiency



Public investment multiplier in LAC, conditioned to the level of efficiency (p10 and p90)

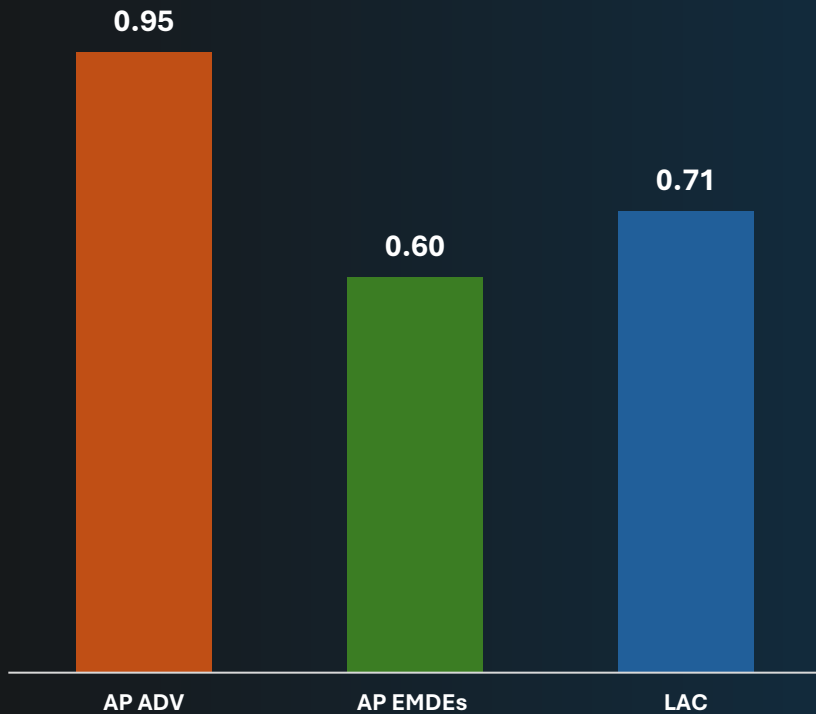


Public investment multiplier in LAC, across the entire efficiency distribution

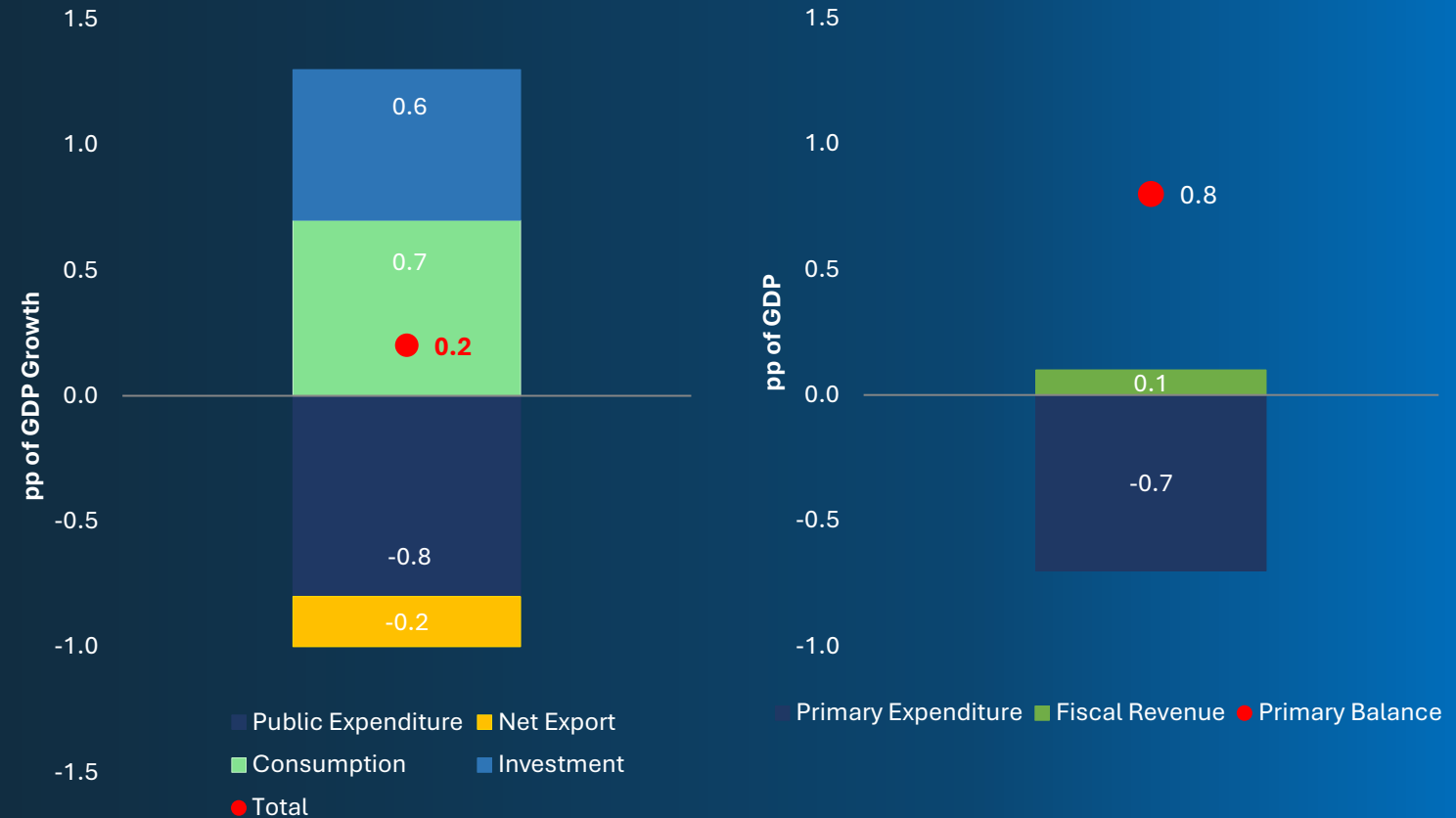


Higher efficiency in procurement spending could boost economic growth

Procurement Efficiency



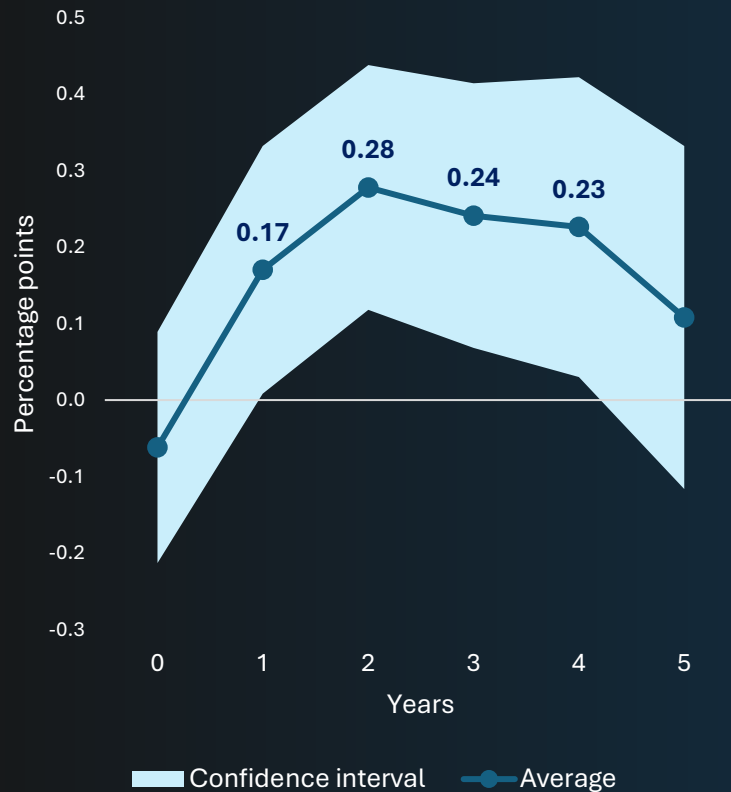
Impact of reducing procurement inefficiency on GDP growth and primary balance



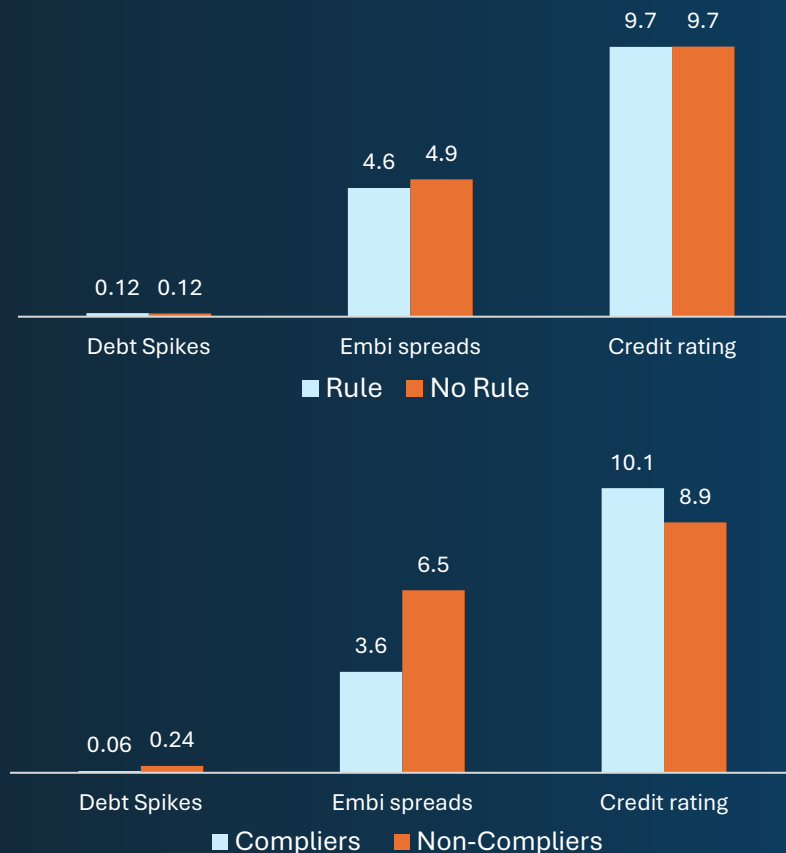
Note: IDB-FMM FISLAC from Guerra-España et. al (2026). *The fiscal cost of waste: procurement spending inefficiency in a General Equilibrium Framework*. IADB Working Papers (Forthcoming). The efficiency score is calculated using Data Envelopment Analysis with VRS-Output orientation, using procurement expenditure (% GDP, IMF_GFS) as input and a composite index of development indicators as output from different sources (IMF, WB, WEO, IEA, among others).

Fiscal institutions are key to achieving the fiscal space for public investment and the credibility to reduce the cost of private capital

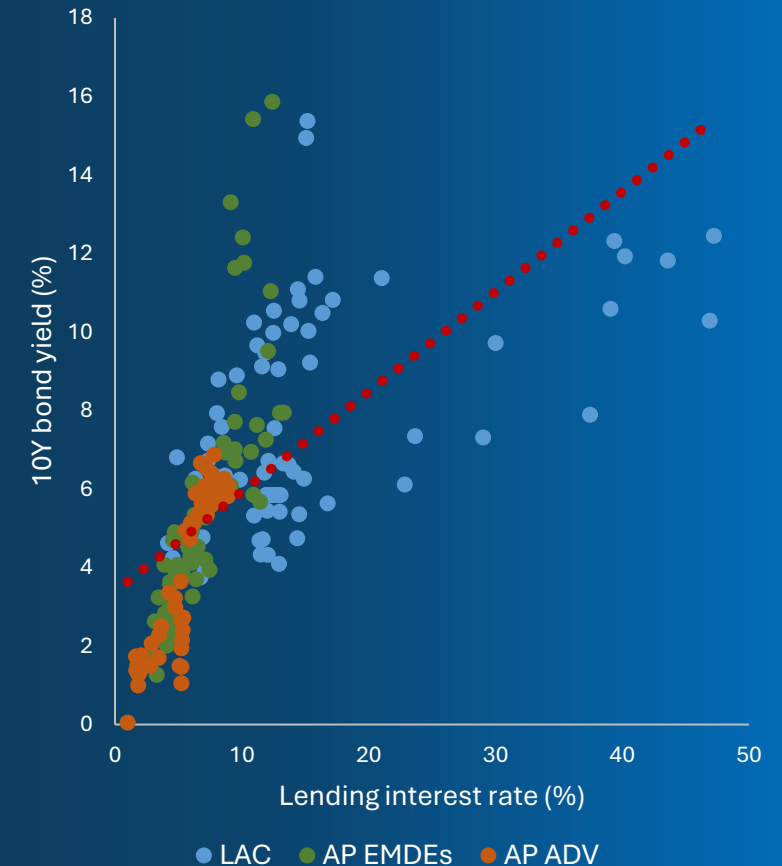
Compliance Effect on Public Investment (%)



Fiscal rule, compliance and performance: difference in means test



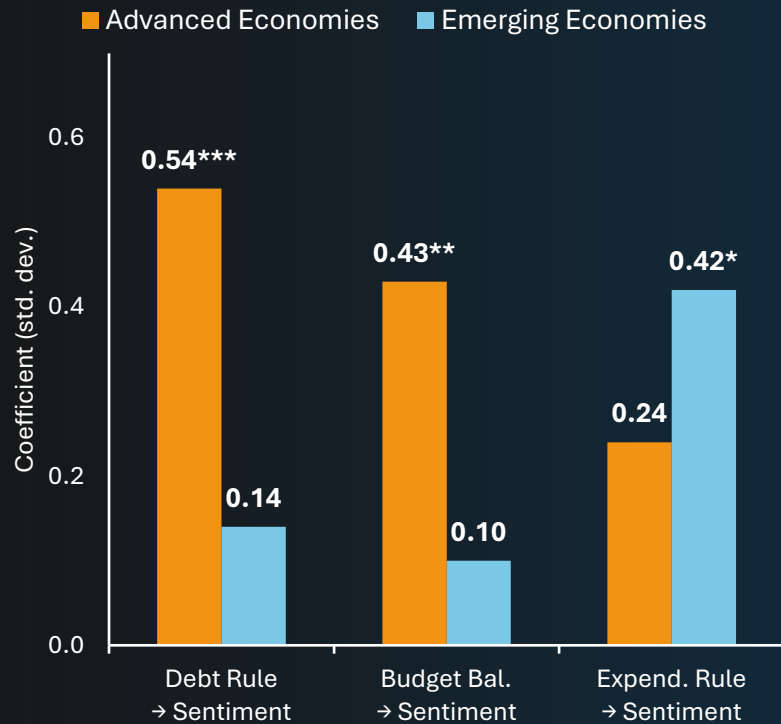
Public-private financing costs (%)



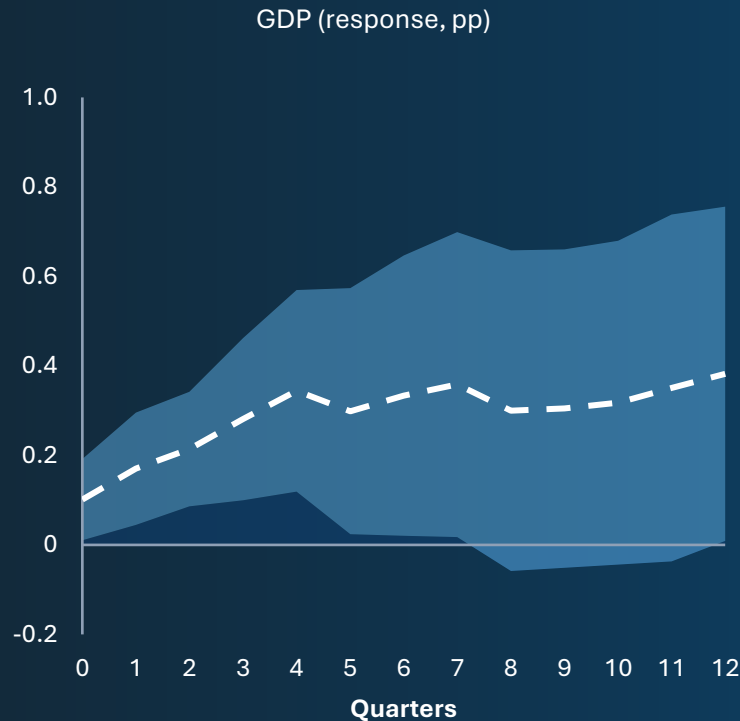
Source: Ruiz-Arranz et al (2025) - Unveiling the Truth: How Sticking to Fiscal Rules Boosts Investment in Latin America; Ardanaz et al (2024) – Why don't we follow the rules? Drivers of compliance with fiscal policy rules in emerging markets, and FISLAC – IFD/FMM – IDB, based on Bloomberg and WB.

Credible fiscal institutions improve market sentiment towards fiscal policy, which can mitigate contractionary shocks

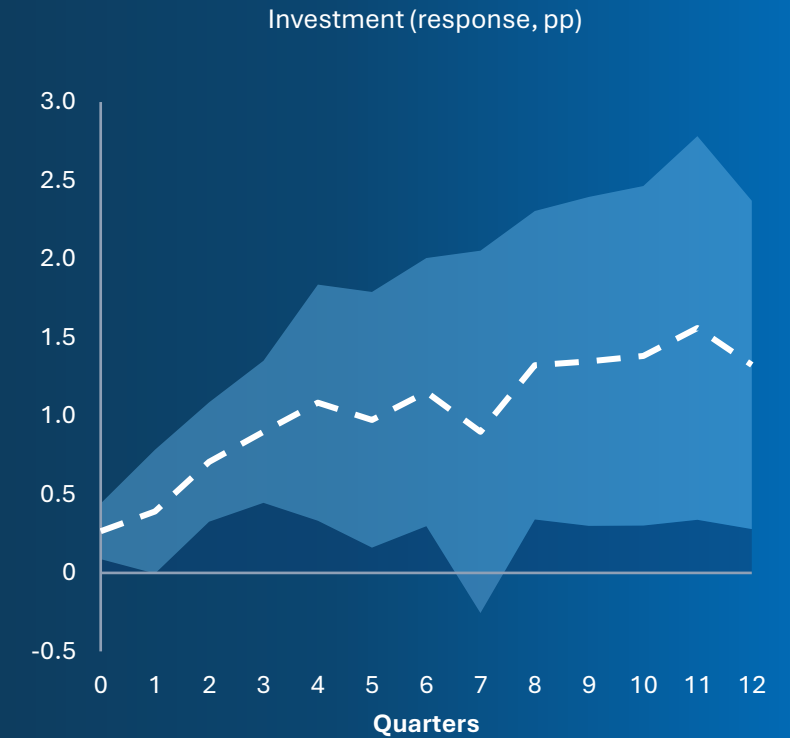
Effect of fiscal rules on firm perceptions



Contractionary shock – Interaction with sentiment



Contractionary shock – Interaction with sentiment



Note: Estimates from Andrian & Hirs-Garzón (2026). Panel regressions with country and year FE; perceptions standardized within country. Significance: *** p<0.01 ** p<0.05 * p<0.1. Hirs-Garzón, Andrian & Valencia (2026). Dashed line = point estimate; shaded band = 95% CI.

Main takeaways

- Fiscal policy should move beyond stabilization and play a stronger role in supporting long-term economic growth.
- Growth-enhancing fiscal policy rests on three pillars: efficient and stable tax systems, efficient public spending, and credible fiscal institutions.
- Strengthening tax stability, reducing compliance costs, and improving the design of corporate taxation can foster investment, productivity, formalization, and economic growth.
- Reducing spending rigidities can enhance fiscal policy flexibility, improve macroeconomic stabilization, and create room for pro-growth expenditure; while enhancing the efficiency of public investment and procurement can generate substantial gains in fiscal policy and growth.
- Strengthening fiscal institutions and complying with them can lower financing costs, expand fiscal space, and support private investment.



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