Inflation as a Fiscal Phenomenon: Evidence from Latin America

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Robert Barro
Francesco Bianchi
Carlos Giraldo
Iader Giraldo-Salazar

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Robert Barro [1]
Francesco Bianchi [2]
Carlos Giraldo [3]
Iader Giraldo-Salazar [4]

Abstract[5]

This paper investigates the relationship between fiscal policy and inflation in a group of Latin American countries during the period 2002 to 2023. Building on the fiscal theory of the price level and recent empirical work by Barro and Bianchi (2025), we examine how fiscal expansions affected inflation dynamics in the region, with a particular focus on fiscal expansions during the pandemic era. Using both OLS and dynamic panel models, we find robust evidence that increases in primary government expenditure significantly contributed to higher headline and core inflation. Our analysis incorporates a composite spending variable that adjusts for the size and maturity of public debt, revealing that inflationary effects are more pronounced in countries with shorter debt maturities and weaker fiscal credibility. Unlike in OECD countries, the inflationary impact of fiscal policy in Latin America persists even outside the COVID-19 period, suggesting structural vulnerabilities. These findings underscore the importance of credible fiscal frameworks and coordinated macroeconomic policies to maintain price stability in emerging markets.

Keywords: CFiscal inflation, fiscal spending, COVID pandemic, Latin America.

JEL Classification: D91, E32, E71.

[1] Harvard University, NBER. Email: rbarro@harvard.edu

[2] Johns Hopkins University, CEPR, and NBER. Email: francesco.bianchi@jhu.edu

[3] Latin American Reserve Fund. Email: cgiraldo@flar.net

[4] Latin American Reserve Fund. Email: igiraldo@flar.net

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Content

1. Introduction

The COVID-19 pandemic marked a turning point in global macroeconomic dynamics, reviving debates around the fiscal origins of inflation. While inflation had remained subdued in many advanced economies for decades, the massive fiscal responses to the pandemic, combined with supply chain disruptions and commodity price shocks, triggered a sharp and persistent rise in prices. This phenomenon has prompted renewed interest in the fiscal theory of the price level (FTPL), which posits that inflation can emerge from unsustainable fiscal trajectories, particularly when monetary policy accommodates fiscal expansion.

Building on the recent work of Barro and Bianchi (2025), which documents a strong link between pandemic-era fiscal stimuli and post-pandemic inflation in OECD countries, this study extends the analysis to a broader set of Latin American economies. We focus on Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, and Uruguay over the period from 2002 to 2023. Our findings confirm that fiscal policy played a central role in shaping inflation dynamics in the region, while also revealing notable differences from the OECD experience. The FTPL provides the conceptual foundation for this analysis. According to this theory, the price level adjusts to ensure that the real value of government debt equals the present discounted value of expected future primary surpluses. When governments increase spending without a corresponding plan to raise future revenues or cut expenditures, the resulting fiscal imbalance must be resolved through higher inflation, which erodes the real value of outstanding debt.

Barro and Bianchi (2025) formalize this mechanism by introducing a model in which a temporary increase in government spending leads to a persistent rise in inflation, especially when debt maturity is long and the stock of debt is large. The inflationary impact is magnified when fiscal credibility is weak, as markets anticipate future monetization of debt. This framework is particularly relevant for Latin America, where fiscal institutions are often less robust and inflation expectations are more sensitive to policy signals. In the proposed conceptual framework, a larger amount of outstanding debt reduces the required increase in inflation, as a given rise in inflation devalues a larger stock of nominal debt. A longer duration allows policymakers to exploit revaluation effects and spread the inflationary adjustment over a longer period, implying a smaller but more prolonged increase in inflation.

In this paper, we present a comprehensive empirical investigation into the inflationary consequences of fiscal expansions in Latin America, focusing on the post-pandemic period from 2020 to 2023. Our analysis builds on and extends the theoretical framework developed by Barro and Bianchi (2025). To test the predictions of this framework, we employ both cross-sectional and dynamic panel regression techniques. Our cross-sectional regressions are based on the composite spending variable introduced in Barro and Bianchi (2025), which

adjusts the size of the fiscal stimulus for the size and maturity of public debt. This approach allows us to isolate the inflationary effects of government spending from other macroeconomic influences and to assess the persistence of these effects over time.

Our baseline cross-sectional regressions reveal a strong and statistically significant relationship between the composite spending variable and both headline and core inflation. These results suggest that countries that undertook larger fiscal expansions experienced more pronounced inflationary pressures. In this respect, our findings are consistent with those reported by Barro and Bianchi (2025). However, our results diverge from Barro and Bianchi (2025) in terms of the role played by outstanding debt and its duration. When these two variables are held constant at their sample means, the model's explanatory power increases. This suggests that, for the specific subset of Latin American (LATAM) countries considered in our analysis, the size and duration of outstanding debt may play a less prominent role in guiding central bank decisions regarding inflation control.

One possible interpretation is that LATAM countries are more concerned with the reputational consequences of allowing inflation to remain elevated over time. Alternatively, the share of debt denominated in domestic versus foreign currency may be more relevant for these countries than for the broader OECD sample examined by Barro and Bianchi (2025). In both cases, these findings point to structural differences in how fiscal policy interacts with inflation across regions. It is therefore worth investigating whether the strong relationship between inflation and fiscal spending holds in other periods and under different macroeconomic conditions.

To further explore the connection between inflation and spending, we estimate a series of dynamic panel models that incorporate lagged inflation terms, fiscal variables, and a rich set of macroeconomic controls. These models confirm that fiscal expansions have a persistent and positive effect on inflation, even after accounting for real GDP growth, commodity price shocks, and geopolitical disruptions such as the war in Ukraine. Interestingly, we find that real economic activity exerts a negative influence on inflation, suggesting the presence of stagflation dynamics in several countries. Moreover, energy and non-energy commodity prices emerge as significant drivers of inflation, consistent with the structural dependence of Latin American economies on commodity exports.

The key insight from our analysis that the inflationary impact of fiscal policy in Latin America remains robust even when we do not adjust for debt maturity and size suggests an important departure from the findings in OECD countries. This divergence may reflect reputational concerns and historical experiences with inflation in the region, which heighten the sensitivity of inflation expectations to fiscal shocks. In particular, countries with a legacy of debt monetization and limited monetary independence appear more vulnerable to inflatio-

nary pressures arising from fiscal expansions. Taken together, our findings highlight the central role of fiscal policy in shaping inflation dynamics in Latin America. They point to the need for stronger fiscal institutions, improved debt management practices, and enhanced coordination between fiscal and monetary authorities. By identifying the structural factors that amplify the transmission of fiscal shocks to inflation, our study contributes to a deeper understanding of macroeconomic vulnerabilities in emerging markets and offers actionable insights for policymakers seeking to safeguard price stability in the face of future crises.

This paper connects to the extensive literature on monetary-fiscal policy interactions (see, among others, Sargent and Wallace (1981), Leeper (1991), Sims (1994), Woodford (1995, 1996, 2001), Cochrane (1998, 2001), Bassetto (2002), Reis (2017), and Bassetto and Sargent (2020)). Barro (1974) shows that non-Ricardian effects can arise when agents mistakenly treat government bonds as net wealth.

The empirical work on emerging economies typically builds on the quantity theory of money, with an implicit understanding that money printing is a response to fiscal issues (Sargent et al., 2009). In recent years, a series of papers have shown that monetary/fiscal policy interaction is important to understand inflation dynamics in advanced economics, and not just emerging economies. Bianchi and Ilut (2017) estimate a regime-switching model linking the high inflation of the 1960s and 1970s to a fiscally-led regime. Bianchi and Melosi (2022, 2017) argue that expectations of a return to such a regime help explain the absence of deflation after the Great Recession and the inflation surge following the pandemic. Bianchi et al. (2023) introduce a new class of general equilibrium models with partially unfunded debt. They demonstrate that unfunded fiscal shocks play a significant role in explaining persistent inflationary episodes in the United States, including in the aftermath of the COVID-19 pandemic. Relatedly, Hall and Sargent (2025) argue that post-pandemic US fiscal imbalances, if not corrected, will lead to higher inflation and higher nominal interest rates on US bonds.

2. Conceptual framework

In what follows, we review the key steps thar Barro and Bianchi (2025) use to connect the size of the pandemic fiscal stimulus to the subsequent rise in inflation. At the heart of the theoretical framework lies the government's intertemporal budget constraint, which equates the real value of outstanding government debt to the present value of future primary surpluses. This relationship is expressed as:

$$\frac{B_t}{P_t} = \sum_{h=1}^{\infty} \frac{T_{t+h} - G_{t+h}}{(1+r)^h} \tag{1}$$

Here, B_t denotes the nominal market value of government debt at the beginning of period t, while P_t is the price level. The terms T_{t+h} and G_{t+h} represent real tax revenues and real primary government spending in future periods, respectively, and r is the constant real interest rate. This equation assumes that governments cannot engage in Ponzi schemes, meaning they must eventually finance their debt through future surpluses.

During crises such as the COVID-19 pandemic, governments often respond with a surge in public spending. This increase is typically unexpected and temporary, lasting for M periods before returning to pre-crisis levels. The cumulative impact of this fiscal expansion, relative to the size of the economy, can be captured by the sum:

$$\sum_{h=0}^{M} \Delta \left(\frac{G_{t+h}}{Y_{t+h}} \right) \tag{2}$$

Where Y_{t+h} denotes real GDP in each period. This formulation highlights the scale of the fiscal impulse in terms of its deviation from the historical norm.

The model assumes that the government's debt obligations—comprising both coupon and principal payments—are structured to rise in line with nominal GDP. In response to the fiscal shock, inflation is assumed to increase above its target level π^* for T periods. This inflationary response reduces the real value of nominal debt, as reflected in the market's valuation of long-term bonds. The monetary authority is presumed to accommodate this inflation path, implying a cooperative stance between fiscal and monetary policymakers.

The change in the market value of debt resulting from this inflationary episode is:

$$\Delta B = B_t^* \left[\sum_{j=1}^{T} \left(\frac{(1+\pi^*)^j}{\prod_{k=1}^{j}(1+\pi_{t+k})} - 1 \right) \right] \tag{3}$$

In this expression, B_t^* is the nominal value of outstanding debt, and π_{t+k} represents the actual inflation rate in each future period. The formula captures how deviations from the expected inflation path reduce the present value of future debt payments.

In the special case where inflation remains constant at a level $\pi > \pi^*$ for T periods, the change in debt value simplifies to a more tractable approximation:

$$\Delta B \approx -B_t^* \cdot \frac{1}{2} T (\pi - \pi^*) \tag{4}$$

This linear approximation shows that the inflation-induced reduction in debt value is proportional to the size of the debt, the duration of the inflation episode, and the inflation gap. A larger amount of outstanding debt enhances the revaluation effect generated by a given change in inflation, while a longer duration allows policymakers to spread a given jump in the price level over multiple periods.

Building on this theoretical foundation, Barro and Bianchi (2025) derive a parsimonious expression that links the change in inflation to the magnitude of the fiscal stimulus, scaled by the size and maturity of the government's debt:

$$\pi - \pi^{*} = \eta \left(\sum_{i=1}^{M} \frac{\Delta G_{t+h}}{Y_{t+h}} \right) \Big/ \left(\frac{B_{t}^{*}}{P_{t} Y_{t}} \frac{T}{2} \right) \tag{5}$$

Equation 5 outlines the core relationship used in the empirical analysis. At a basic level, it shows that inflation tends to rise more when there's a larger cumulative increase in government spending relative to GDP over time (i.e., when G_{t+h}/Y_{t+h} grows more for $h = 1, \ldots, M$). More surprisingly, the model also predicts that inflation rises more when the starting debt-to-GDP ratio, $B_{t}^{*}/(P_{t} Y_{t})$, is lower. This is because a larger initial debt implies that every given increase in inflation serves to devalue a larger amount of debt. In other words, inflation is a more effective source of financing because it acts on a larger implicit "tax base."

The model also highlights the role of debt maturity. When the average maturity of government debt (measured as $T/2$) is longer, the required increase in inflation is smaller. The logic is that, for a given total increase in government spending, spreading the inflationary adjustment over a longer time horizon reduces the amount of inflation needed in each period to achieve the same reduction in the real value of debt. This effect stems from how inflation expectations and nominal interest rates influence the market value of debt.

In essence, the model suggests that inflation responds to a fiscal pressure index: the total increase in government spending relative to GDP, scaled by the initial debt burden and the average maturity of debt. The parameter η captures the sensitivity of inflation to fiscal shocks. The denominator includes the real debt-to-GDP ratio and the square of the debt maturity, reflecting the idea that larger and longer-term debt can absorb fiscal shocks with less inflationary pressure.

A key insight of Barro and Bianchi (2025) is that the parameter η is not necessarily constant across time. Under normal economic conditions, when fiscal expansions are expected to be offset by future surpluses, $\eta = 0$, consistent with standard intertemporal public finance. However, during emergencies such as the COVID-19 crisis or major wars, $\eta > 0$, indicating that fiscal expansions can lead to inflation. This state-contingent be-

havior aligns with the framework proposed by Lucas and Stokey (1983), where fiscal policy becomes more flexible in response to extraordinary circumstances.

To empirically test this relationship, the authors estimate a panel regression of the form:

$$\pi_{it} = \pi_i^* + \eta \cdot (\Delta G)_{it} + X_t + \beta Z_t + u_{it} \quad (6)$$

In this specification, π_{it} is the observed inflation rate in country i at time t, π_i^* is a country-specific fixed effect, and X_t captures year-specific shocks such as the global impact of the pandemic. The variable Z_t is a temporal dummy variable introduced in the regression analysis to account for the effects of the war in Ukraine, included to account for geopolitical spillovers. They find that the composite government variable plays a key role in explaining the cross-sectional variation of inflation outcomes in the aftermath of the pandemic. Furthermore, they show that all components of the government spending variable play a role in accounting for the inflation outcomes.

Barro and Bianchi (2025) obtain similar results when considering the cross-sectional variation in the *change* in inflation:

$$\Delta \pi_{it} = \eta \cdot (\Delta G)_{it} + \beta Z_{it} + u_{it} \quad (7)$$

In this specification, $\Delta \pi_{it}$ is the change in inflation before and after the pandemic.

3. Data and Empirical Specification

In this section, we describe the data and econometric models used in our empirical analysis. The empirical analysis employs both OLS and dynamic panel models to estimate the relationship between fiscal variables and inflation.

3.1. Data

The dataset includes annual data from 2002 to 2023 for the following countries: Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, and Uruguay. In what follows, we describe the key variables.

3.1.1. CPI inflation rates

The headline inflation rates are calculated using the consumer price indexes (CPI) values, as reported in the World Economic Outlook (WEO) from the IMF. For each country in the sample, the values of inflation were grouped by periods: 2010-2019 (pre-crisis) and 2020-2023 (crisis). The core inflation rates are calculated from the World Bank's A Global Database of Inflation, for the economies that publish this data in their national accounts. Bolivia, Ecuador, and Uruguay do not publish core CPI data. For more details, see Table 1 and Table 2.

Table 1. Headline Consumer Price Indexes

Country	(1)	(2)	(3)	(4)
	Change in inflation rate	Inflation rate 2010-19	Inflation rate 2020-23	Fitted inflation rate 2020-23
Bolivia	-0.0280	0.0430	0.0150	-0.0005
Brazil	0.0052	0.0582	0.0635	0.0006
Chile	0.0379	0.0291	0.0670	0.0306
Colombia	0.0325	0.0374	0.0699	0.0027
Costa Rica	-0.0034	0.0315	0.0281	-0.0058
Ecuador	-0.0119	0.0256	0.0137	-0.0028
Mexico	0.0167	0.0396	0.0563	0.0074
Paraguay	0.0106	0.0418	0.0524	0.0163
Peru	0.0219	0.0280	0.0499	0.0314
Uruguay	0.0008	0.0804	0.0812	0.0025
Mean	***0.0082***	***0.0415***	***0.0497***	***0.0082***

Note: Inflation rates are averages over the periods indicated, based on changes in annual averages of CPI values. Headline inflation data are from the IMF's April 2025 WEO database. The change in the inflation rate in column 1 is calculated as the difference between the average values for 2020-2023 and those for 2010-2019. Column 2 is the average value from 2010 to 2019. The values in column 4 represent the adjusted results of the OLS regression based on the sampled countries.

Table 2. Core Consumer Price Indexes

Country	(1)	(2)	(3)	(4)
	Change in inflation rate	Inflation rate 2010-19	Inflation rate 2020-23	Fitted inflation rate 2020-23
Bolivia	-	-	-	-
Brazil	-0.0003	0.0569	0.0566	0.0020
Chile	0.0306	0.0237	0.0543	0.0203
Colombia	0.0151	0.0369	0.0520	0.0033
Costa Rica	-0.0122	0.0317	0.0194	-0.0019
Ecuador	-	-	-	-
Mexico	0.0129	0.0340	0.0468	0.0062
Paraguay	0.0084	0.0429	0.0513	0.0117
Peru	0.0081	0.0310	0.0391	0.0209
Uruguay	-	-	-	-
Mean	***0.0089***	***0.0367***	***0.0457***	***0.0089***

Note: Core inflation data are from the World Bank's A Global Database of Inflation; Bolivia, Ecuador, and Uruguay do not publish core CPI data. Column 1 is calculated as the difference between the average values for 2020–2023 and those for 2010–2019. Column 2 is the average value from 2010 to 2019. Column 3 is the average value between 2020–2023. Column 4 presents the adjusted results of the OLS regression based on the sampled countries.

3.1.2. Government spending

This variable considers the information on general government primary expenditure, which is the difference between the general government's total expenditure and interest expenditure (paid on public debt), as a percentage of GDP. These data are from the IMF: WEO, Public Finances in Modern History, and IFS databases (Table 3). The paper argues that the main surge in government spending occurred in 2020 and 2021, driven by fiscal efforts to mitigate the impact of the COVID-19 pandemic. Therefore, the analysis focuses on the ratios of government spending to GDP for those years, measured relative to a baseline ratio from 2019 (pre-crisis).

Table 3. Fiscal Variables Base on IMF Data for General Government

Country	(1)	(2)
	Excess Govt Spending relative to GDP 2020-21	Gross debt relative to GDP 2019
Bolivia	0.0015	0.5863
Brazil	0.0102	0.8712
Chile	0.0972	0.2833
Colombia	0.0139	0.5240
Costa Rica	-0.0156	0.5643
Ecuador	-0.0080	0.5166
Mexico	0.0359	0.5186
Paraguay	0.0423	0.2577
Peru	0.0763	0.2696
Uruguay	0.0169	0.5963
Mean	***0.0271***	***0.4988***

Note: The government spending is the difference between general government spending and the interest paid on public debt, expressed as a percentage of GDP. The values in column 1 represent the sum of those ratios to GDP for the years 2020 and 2021, expressed relative to the 2019 ratio. The values in column 2 correspond to the general government gross debt as a percentage of GDP for the year 2019. The data are from the IMF's April 2025 WEO, Public Finances in Modern History, and IFS databases.

3.1.3. Quantities of public debt

For this paper, the public debt is considered as the gross debt of the general government to GDP. The data are from the IMF WEO database; specifically, the values used in the analysis correspond to 2019.

3.1.4. Duration of public debt

In contrast with Barro and Bianchi (2025), data for the Latin American countries is not widely available in OECD databases, so the duration of public debt D_t was computed using data from S&P Capital IQ. In the empirical model, the expression $T/2$ corresponds to D_t, which is computed as the weighted averages of the remaining duration of debt, measured as the difference between the bond's maturity date and the year under

analysis, and weighted by the offering amount (Table 4). It is equivalent to T, originally defined as the average remaining time to maturity reported by the OECD.

To calculate the values in Column 1, we used data on the remaining maturity of government bonds, defined as the time left between 2019 and the bonds' maturity date, weighted by their issued value. Data was sourced from S&P's Capital IQ. Then a linear regression was performed using the average remaining maturity in 2019 from the OECD as the dependent variable, and the remaining maturity from Capital IQ as the independent variable, based on data available for Chile, Colombia, Costa Rica, and Mexico. Using the estimated regression coefficients (intercept and slope), the values of average remaining maturity 2019 (column 1) were calculated for all countries.

Table 4. Characteristics of Public Debt 10 Latin American Countries

Country	(1)	(2)	(5)
	Average remaining maturity 2019	Estimated duration 2019	Composite govt-spending variable
Bolivia	8.7510	6.1400	0.0004
Brazil	9.5192	6.8754	0.0017
Chile	11.9000	8.9000	0.0386
Colombia	8.6000	6.2000	0.0043
Costa Rica	6.4000	4.5000	-0.0061
Ecuador	9.0098	6.4196	-0.0024
Mexico	9.9000	6.9000	0.0100
Paraguay	10.2899	7.8022	0.0211
Peru	9.4652	7.1417	0.0396
Uruguay	9.5615	7.0155	0.0040
Mean	***9.3397***	***6.7894***	***0.0111***

Note: The first two columns of the table report information about the average maturity (first column) and the estimated duration of outstanding debt. The last column reports the composite government variable capturing the change in spending rescaled by the amount and duration of outstanding debt.

In column 2, the estimated duration of the public debt is calculated by applying the iterative equation for D_t for Brazil, Chile, Colombia, Costa Rica, Mexico, and Peru. The information associated with nominal interest rates of long-term sovereign debt (10year government bonds) is not available for Bolivia, Ecuador, Paraguay, and Uruguay. For these countries, we performed a regression between D_t and the average remaining maturity in

2019 from the OECD (data available for Chile, Colombia, Costa Rica, and Mexico), then, using the constant and coefficient from the regression, we estimated a linear equation by applying the remaining maturity data from Capital IQ. Final values are reported in the second column.

In column 3, the composite government-spending variable is constructed by dividing the excess government spending from Table 2, column 1, by the ratio of gross public debt to GDP from Table 2, column 2, and divided by the estimated duration from Table 3, second column. We observe significant variation in the composite spending variable, with countries showing negative values (Costa Rica and Ecuador), while other countries present a large positive value (Chile and Peru).

3.1.5. Other variables

In this subsection, we describe a series of additional variables that are used to control for other possible factors affecting inflation.

- Real GDP

Used as a standard regression control, the real GDP in US dollars is sourced from the IMF's WEO database, April 2025 edition. Data included in the analysis was transformed using natural logarithms.

- War in Ukraine

Since the Latin American countries do not share a border with Ukraine, a temporal dummy variable is introduced in the regression analysis to account for the broader effects of the war in Ukraine. This variable takes the value of one for the years 2022 and 2023, and zero otherwise.

- Energy Index

To account for external price shocks, the analysis incorporates an energy commodity price index that captures the variability in international prices over the sample period. This index, sourced from the World Bank's Commodity Price Data (Pink Sheet), reflects yearly price movements of key energy commodities, namely coal, crude oil and natural gas, which are particularly relevant for commodity-exporting economies. Given Latin America's structural dependence on commodity exports, fluctuations in global energy prices can significantly affect external balances, fiscal revenues, and broader macroeconomic conditions. Accordingly, the

index serves as a proxy for international terms-of-trade volatility and is included in the empirical specification to control for exogenous external shocks beyond the influence of domestic fundamentals.

- Non-energy Index

As the energy commodity price index, the analysis also includes a non-energy commodity price index to account for fluctuations in international prices of other key export products. This index, obtained from the World Bank's Commodity Price Data (Pink Sheet), captures price dynamics in agricultural goods, fertilizers and metals and minerals, all of which are highly relevant to the external sector performance of Latin American economies. This measure aims to control other exogenous shocks to global non-energy commodity markets.

Table 5. Means and Standard Deviations of Variables

Variable	*(1)*	*(2)*	*(3)*	*(4)*
	Mean	*SD*	*Max.*	*Min.*
Headline CPI inflation rate, 2010-2019	0.041	0.017	0.080	0.026
Headline CPI inflation rate, 2020-2023	0.050	0.023	0.081	0.014
Change in headline CPI inflation rate	0.008	0.020	0.038	-0.028
Core CPI inflation rate, 2010-2019	0.037	0.011	0.057	0.024
Core CPI inflation rate, 2020-2023	0.050	0.013	0.057	0.019
Change in Core CPI inflation rate	0.009	0.013	0.031	-0.012
Δ(G/Y) (primary govt spending as ratio to GDP, cum. 2020-21 vs 2019)	0.027	0.036	0.097	-0.016
Gross public debt/GDP (2019)	0.499	0.188	0.871	0.258
Composite govt-spending variable	0.011	0.016	0.040	-0.006
Primary Expenditure in LN(USD)	3.405	1.649	6.787	0.126
Real GDP in LN(USD)	4.663	1.513	7.525	1.139
Ukraine War	0.091	0.288	1.000	0.000
Energy index	88.698	25.208	129.905	44.889
Non-energy index	87.340	13.410	107.717	58.830

Note: Statistics refer to the 10 Latin American countries considered in the sample (Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, and Uruguay).

3.2. Empirical Specification

Our empirical investigation relies on three key econometric specifications, each designed to uncover the relationship between fiscal spending and inflation across countries.

We begin with our baseline cross-sectional analysis using Ordinary Least Squares (OLS). This specification examines how the variation in headline inflation across countries correlates with the variation in a composite measure of government spending:

$$\Delta \text{Headline CPI}_{\,i} = \beta_0 + \beta_1 \text{ Composite Government Spending Variable}_i + \epsilon_{i,t} \tag{8}$$

The identification strategy hinges on the assumption that cross-country differences in the magnitude of fiscal spending are exogenous to inflation outcomes. Crucially, this does not imply that the decision to increase spending is unrelated to macroeconomic conditions; rather, it assumes that the heterogeneity in spending across countries is not systematically driven by unobserved inflationary pressures.

We also consider variations of the baseline regressions in which one of the three components of the composite spending variable is restricted to its sample mean. This allows us to assess whether all three components contribute equally to explaining the cross-sectional variation in inflation.

To capture the dynamic nature of inflation and its potential persistence, we next employ a Dynamic Panel Model. This specification allows us to explore how inflation responds over time to changes in primary government expenditure:

$$\begin{aligned}\text{HeadlineCPI}_{i,t} = \beta_0 + \beta_1 \Delta \text{ HeadlineCPI}_{i,t-1} + \beta_2 \Delta \text{ HeadlineCPI}_{i,t-2} \\ + \beta_3 \Delta \text{ Primary Expenditure}_{i,t} + \beta_4 \Delta \text{ Primary Expenditure}_{i,t-1} + \varepsilon_{i,t}\end{aligned} \tag{9}$$

This model incorporates lagged inflation terms to account for inertia in price dynamics, while also including both contemporaneous and lagged changes in fiscal spending. The aim is to provide a more nuanced understanding of the temporal link between government expenditure and inflation, focusing specifically on the Latin American countries in our dataset.

Finally, we extend the Dynamic Panel Model by introducing a comprehensive set of control variables commonly associated with inflationary behavior. This enriched specification enables us to test the robustness of the spending-inflation relationship in the presence of broader macroeconomic influences:

$$\begin{aligned}\text{HeadlineCPI}_t = {} & \beta_0 + \beta_1 \Delta \ \text{HeadlineCPI}_{i,t-1} + \beta_2 \Delta \ \text{HeadlineCPI}_{i,t-2} \\ & + \beta_3 \text{DeltaPrimaryExpenditure}_{i,t} + \beta_4 \Delta \ \text{Primary Expenditure}_{i,t-1} \\ & + \beta_5 \Delta \ \text{Real GDP}_{i,t} + \beta_6 \Delta \ \text{Real GDP}_{i,t-1} + \beta_7 \Delta \ \text{Energy}_{i,t} + \beta_8 \Delta \ \text{Energy}_{i,t-1} \\ & + \beta_9 \Delta \ \text{Non Energy}_{i,t} + \beta_{10} \Delta \ \text{Non Energy}_{i,t-1} + \beta_{11} \text{Delta Ukraine} + \varepsilon_{i,t}\end{aligned} \tag{10}$$

By controlling for real economic activity (real GDP), commodity price shocks (energy and non-energy components), and geopolitical disruptions (captured by the Ukraine variable), this specification allows for a more rigorous assessment of the inflationary impact of fiscal policy. It helps isolate the effect of government spending from other concurrent macroeconomic forces that may confound the observed relationship.

4. Findings

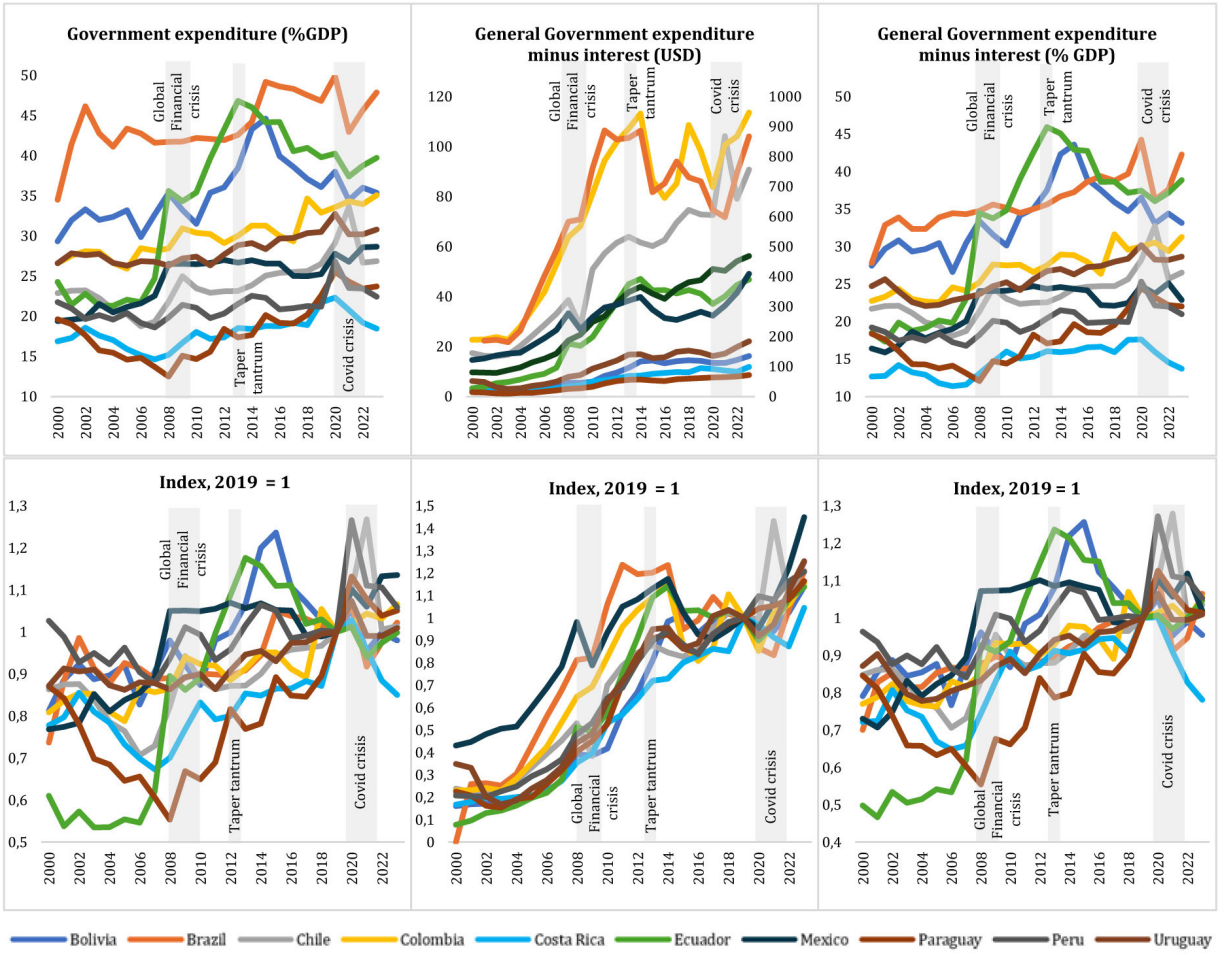
In this section, we present our main findings. We first review some stylized facts, and then present the estimates for our regressions.

4.1. A look at the data

Before presenting the empirical results, it is instructive to begin with a descriptive overview of the data. Figure 1 illustrates the evolution of government expenditure across the countries included in our sample. The three columns display: (i) total government spending as a share of GDP, (ii) total nominal spending, and (iii) primary spending as a share of GDP. In the second row of the figure, all variables are normalized to 1 at the onset of the pandemic, allowing for a clearer comparison of relative changes across countries. Figure 2 complements this by presenting data on headline inflation and debt-to-GDP ratios, offering a broader view of macroeconomic dynamics during the pandemic period.

The data reveal a pronounced surge in government spending during the pandemic, with expenditures increasing markedly as a share of GDP. This fiscal expansion was not accompanied by proportional increases in output, resulting in elevated debt levels and mounting inflationary pressures. However, the magnitude and nature of these responses vary significantly across countries. For instance, Costa Rica experienced a notable contraction in spending, whereas Peru and Chile undertook substantial fiscal expansions.

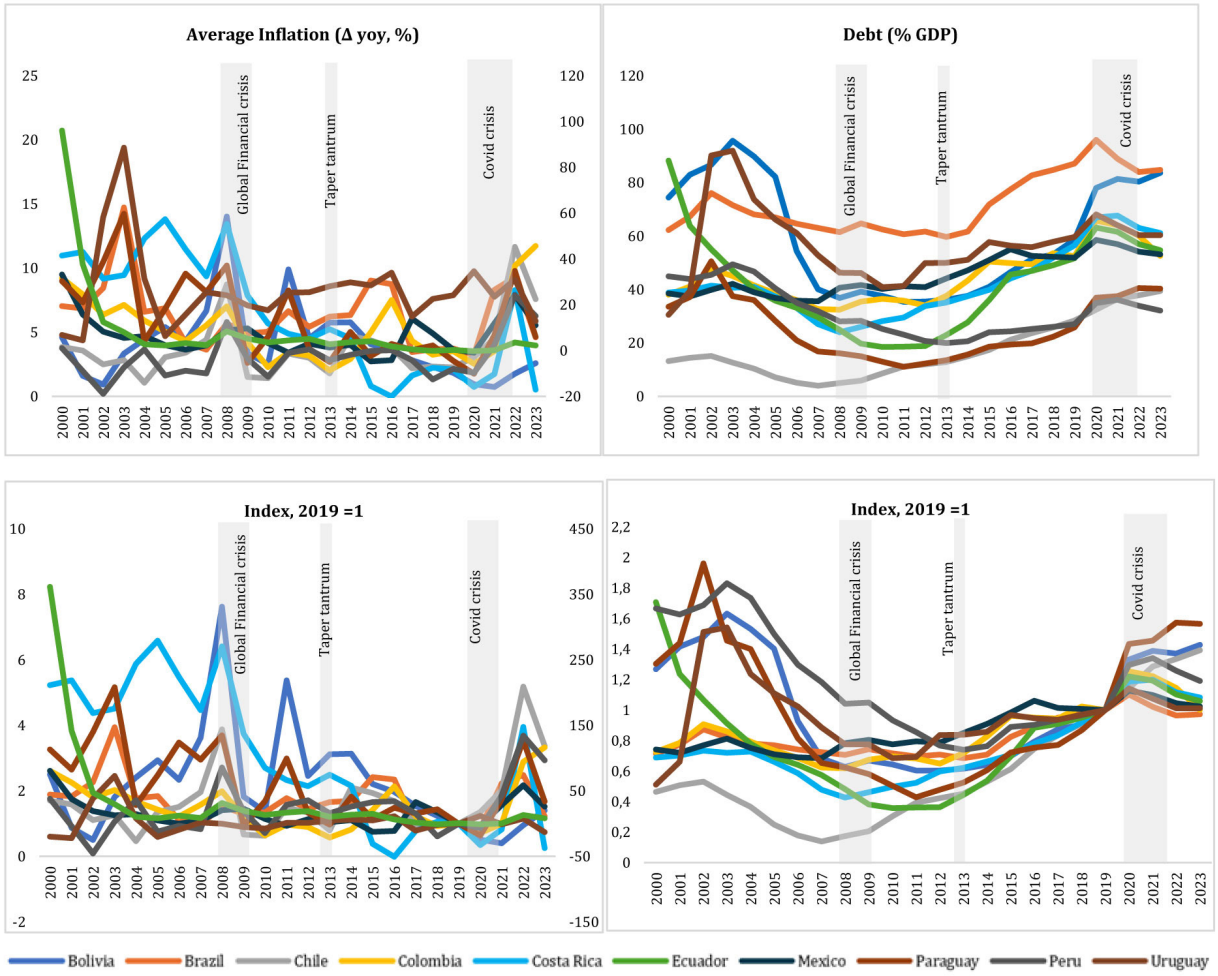
Figure 1. Government Expenditure and Primary Expenditure minus Interests



Note: The bottom graphs transform the top graphs data into an index with 2019 as the base year. Data are from the IMF's April 2025 WEO database and Public Finances in Modern History. Shaded areas correspond to recent crises, including the Global Financial Crisis (2008–2009), the Taper Tantrum (2013), and the COVID-19 pandemic (2020–2022).

This cross-country heterogeneity extends to inflation and debt-to-GDP dynamics. Figure 2 report these two variables. As in the previous figure, the top panel reports the raw data, while the lower panel reports the normalized series. While the average country in the sample saw inflation rise, the extent of this increase differs widely. Chile, for example, stands out with a particularly sharp spike in inflation, while Uruguay experienced the most pronounced increase in debt following the pandemic.

Figure 2. Inflation and General Government Debt



Note: The bottom graphs transform the top graphs data into an index with 2019 as the base year. Data are from the IMF's April 2025 WEO database and Public Finances in Modern History. Shaded areas correspond to recent crises, including the Global Financial Crisis (2008–2009), the Taper Tantrum (2013), and the COVID-19 pandemic (2020–2022).

It is also important to highlight the variation in initial debt levels prior to the pandemic. As discussed earlier, the starting level of debt plays a critical role in determining the inflationary response required to finance unfunded spending. Countries entering the pandemic with higher debt burdens faced more acute trade-offs between inflation and fiscal sustainability.

4.2. Regressions

We now describe the main results. We first examine the baseline regressions focusing on the post-COVID inflation surge and then extend the analysis using the Dynamic Panel Model.

4.2.1. Baseline regressions

We start from our baseline regressions relating the change in inflation to the change in spending rescaled by maturity and the stock of debt. These baseline regressions show a statistically significant relationship between excess government spending and both headline and core inflation. The composite spending variable, which incorporates debt and duration, performs particularly well in explaining cross-country differences in inflation outcomes.

In the first specification, we focus on headline inflation and find that the coefficient on the spending variable is both large and statistically significant (see Column 1 of Table 6). When we shift to core inflation, the coefficient remains statistically significant but is smaller in magnitude, as shown in Column 2 of Table 6. Interestingly, the constant term is not statistically significant in either specification, despite the fact that all countries were exposed to a common global shock—the COVID-19 pandemic. This suggests that differences in inflation outcomes are not driven by shared external factors alone, but rather by country-specific fiscal responses.

Table 6. Regressions for Change in Inflation Rate

Variable	*Headline CPI Inflation Rate*	*Core CPI Inflation Rate*
	(1)	*(2)*
Constant	-0.0008	0.0012
Excess govt spending/(gross debt) duration*	0.8142*	0.4967(.)
Number of observations	10	7
R-squared	0.3752	0.348
s.e of regression	0.0159	0.0107
log(likelihood)	28.33	22.99

*Signif. codes: 0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1.*

Note: The table reports the parameter estimates and summary statistics for the baseline regression relating inflation changes to the composite government spending variable. Column 1 considers headline inflation, while the second column refers to core inflation. Bolivia, Ecuador and Uruguay do not publish core CPI data.

Overall, these findings align closely with the results reported by Barro and Bianchi (2025) for a broad sample of OECD countries. This parallel is particularly noteworthy given the limited overlap between our sample and the OECD: only Chile, Costa Rica, Colombia, and Uruguay are members of the OECD, and most OECD countries are not included in our Latin America-focused analysis. The consistency of results across such distinct samples underscores the robustness of the relationship between fiscal expansions and inflationary dynamics.

4.2.2. Components of the composite government-spending variable

We assess how the statistical significance of the composite government spending variable relates to the individual contributions of its three components. Specifically, we re-estimate the baseline regression by restricting one component of the composite government spending variable at a time to equal the sample cross-sectional mean. Our goal is to evaluate whether the variation induced by each component helps explain the cross-sectional variation in inflation outcomes.

The results are presented in Table 7. Both the R^2 and log-likelihood drop significantly when the size of the fiscal stimulus is held constant across countries (first column). This finding clearly indicates that the size of the fiscal stimulus—or lack thereof—plays a key role in explaining the cross-sectional variation in inflation. In fact, once this source of variation is removed, the variable loses statistical significance. In this respect, our results align with those of Barro and Bianchi (2025), who examine a broad set of OECD countries. However, our findings diverge from Barro and Bianchi (2025) regarding the role of outstanding debt and its duration. When these two variables are restricted to their sample means, the model's explanatory power increases (second and third columns).

This latter result suggests that, for the specific subset of LATAM countries considered in our analysis, the size and duration of outstanding debt may play a less prominent role in guiding central bank decisions on inflation control. One possible interpretation is that LATAM countries are more concerned with the reputational consequences of allowing inflation to persist at elevated levels over time. Alternatively, the share of debt denominated in domestic versus foreign currency may be more relevant for these countries than for the broader OECD sample considered by Barro and Bianchi (2025). Recall that only Chile, Costa Rica, Colombia, and Uruguay are members of the OECD. In both cases, it is worthwhile to investigate whether the strong relationship between inflation and fiscal spending persists in other periods. We address this question in the following subsection.

Table 7. Components of the composite government-spending variable

Variable set as sample mean (fixed average)	*(1)*	*(2)*	*(3)*
	Excess government spending	*Gross debt*	*Duration*
Constant	-0.0122	-0.0021	-0.0009
*Excess govt spending / gross debt * duration*	2.239	1.521**	0.704**
Number of observations	10	10	10
R-squared	0.114	0.514	0.453
s.e. of regression	0.020	0.014	0.015
log(likelihood)	25.99	29.00	28.41
p-values	0.340	0.020	0.033
Relative likelihood (AIC)	-47.99	-54.01	-52.82

*Robust standard errors in parentheses. *** p < 0.01, ** p < 0.05, * p < 0.1.*

Note: The table presents the results of the baseline regression, where one component of the composite government spending variable is held constant at the sample's cross-sectional mean at a time. In Column 1, excess government spending is kept constant; in Column 2, gross debt is held constant; and in Column 3, duration is held constant.

4.2.3. Dynamic Panel Model

We extend our analysis by estimating a Dynamic Panel Model, which allows us to account for inflation persistence and the role of real economic activity. The first two columns of Table 8 present the results from this specification controlling for inflation and real activity. The findings indicate that changes in government spending have a positive and statistically significant impact on inflation. In contrast, real activity does not appear to be a major contributor to inflation dynamics in this context. We also detect meaningful inflation persistence, as lagged inflation terms are statistically significant.

These results suggest that fiscal factors play a central role in shaping inflation outcomes—even outside of crisis periods. The significance of spending shocks, coupled with limited explanatory power from real activity, underscores the importance of fiscal policy as a driver of inflation in Latin American economies.

These insights are further reinforced when we incorporate a richer set of control variables. In this extended specification, additional dynamics emerge that shed light on the broader inflationary environment. The last three columns of Table 8 progressively introduce new controls: changes in energy commodity prices, changes in non-energy commodity prices, and a dummy variable capturing the impact of the war in Ukraine.

Consistent with the more parsimonious specifications in Columns (1) and (2), the change in primary government spending remains positively and statistically significantly associated with inflation. Moreover, its lagged value also contributes positively, suggesting that the inflationary effects of fiscal expansions may persist over time. Alongside fiscal variables, we observe that a broader set of macroeconomic factors co-move with inflation. Both energy and non-energy commodity prices enter the regression with positive and significant coefficients, indicating their direct influence on headline inflation. Interestingly, the dummy variable for the Ukraine conflict also shows a positive and significant effect, highlighting the role of geopolitical shocks in shaping inflation outcomes.

Another noteworthy result is the behavior of GDP growth once these additional controls are included. The coefficients on both current and lagged GDP growth become statistically significant and negative, suggesting the presence of stagflation dynamics—where inflation rises despite weak or contracting economic activity—in several countries within our sample. While this could be the result of adverse energy prices, it could also be due to the strained fiscal situation induced by a contracting economy.

We also experimented with a range of other control variables (see Annex), but none yielded statistically significant results. As such, the final column of Table 8 can be interpreted as a comprehensive summary of the key drivers of inflation dynamics in Latin American economies. The significance of commodity prices is not entirely surprising, given that our sample predominantly consists of small open economies, and the dependent variable is headline inflation, which inherently includes energy and food components.

We also find that, unlike in OECD countries, the inflationary impact of fiscal policy in Latin America is evident even without adjusting for debt maturity and size. One plausible explanation is that many countries in our sample were particularly sensitive to reputational risks stemming from a prolonged history of high inflation. This concern may have heightened the responsiveness of inflation to fiscal expansions and the desire to quickly regain control of inflation, regardless of the structure of public debt.

This interpretation is confirmed by the fact that the relationship between government spending and inflation holds even outside the COVID-19 period, suggesting that structural factors, such as weaker fiscal credibility, “limited” monetary independence, and a legacy of debt monetization, amplify the inflationary effects of fiscal policy. These findings underscore the importance of institutional and historical context in shaping the transmission of fiscal shocks to inflation, and highlight the distinct macroeconomic vulnerabilities faced by Latin American economies.

Table 8. Dynamic Panel Regressions

Variables	(1)	(2)	(3)	(4)	(5)
	Headline Inflation	Headline Inflation	Headline Inflation	Headline Inflation	Headline Inflation
Headline Inflation (t-1)	0.353***	0.330***	0.400***	0.391***	0.393***
	(0.0883)	(0.0855)	(0.0933)	(0.103)	(0.0941)
Headline Inflation (t-2)	-0.129*	-0.121*	-0.0847	-0.0636	-0.0416
	(0.0771)	(0.0711)	(0.0591)	(0.0613)	(0.0494)
Δ Primary Expenditure (t)	0.0432**	0.0848***	0.0629***	0.0593***	0.0650***
	(0.0206)	(0.0303)	(0.0214)	(0.0223)	(0.0204)
Δ Primary Expenditure (t-1)	0.00316	0.0222*	0.0362***	0.0325***	0.0512***
	(0.0117)	(0.0114)	(0.00921)	(0.00907)	(0.00784)
Δ Real GDP (t)		-0.0690	-0.121***	-0.120***	-0.135***
		(0.0434)	(0.0392)	(0.0401)	(0.0405)
Δ Real GDP (t-1)		-0.0294*	-0.0659***	-0.0636***	-0.0607**
		(0.0154)	(0.0218)	(0.0229)	(0.0244)
Δ Energy (t)			0.000524***	0.000400***	0.000382***
			(0.000122)	(0.000106)	(0.000107)
Δ Energy (t-1)			0.000233***	0.000218**	-9.14e-07
			(8.84e-05)	(8.74e-05)	(0.000101)
Δ Non-energy (t)				0.000395*	0.000417**
				(0.000204)	(0.000210)
Δ Non-energy (t-1)				0.000320*	0.000410**
				(0.000173)	(0.000177)
Ukraine					0.0194***
					(0.00629)
Constant	0.0328***	0.0303***	0.0254***	0.0242***	0.0201***
	(0.00706)	(0.00647)	(0.00698)	(0.00681)	(0.00594)
Observations	200	200	200	200	200

Note: Δ = (variable in t) − (variable in t−1); Robust standard errors in parentheses. *** p < 0.01, ** p < 0.05, * p < 0.1.
This estimation presents the results from the extended dynamic panel regression using the full sample of Latin American countries.

5. Policy Implications

The findings of this study carry several important implications for both fiscal and monetary policy in Latin America. They underscore the need for institutional strengthening, strategic coordination, and enhanced resilience to external shocks in order to mitigate inflationary risks and promote macroeconomic stability.

First, there is a clear imperative to strengthen fiscal institutions. Anchoring inflation expectations requires governments to commit to credible and transparent fiscal frameworks that ensure long-term sustainability. This involves adopting rules-based fiscal policies, establishing independent fiscal councils, and improving budgetary transparency. Such institutional reforms can enhance fiscal credibility and reduce the likelihood that spending shocks translate into inflationary pressures.

Second, improving debt management practices is essential. Extending the maturity profile of public debt and diversifying the investor base can help reduce the short-term inflationary impact of fiscal expansions. Longer maturities provide governments with more time to adjust to fiscal shocks, while a broader investor base can enhance market confidence and reduce reliance on inflationary financing.

Third, effective coordination between fiscal and monetary authorities is crucial. Central banks must remain vigilant against the risk of fiscal dominance, where monetary policy becomes subordinated to the financing needs of the government. Preserving central bank independence and ensuring clear, consistent communication between institutions are key to maintaining price stability and preventing inflation from becoming entrenched.

Finally, Latin American economies must build greater resilience to external shocks. Given the region's exposure to volatile commodity prices and global financial conditions, macroeconomic frameworks should incorporate robust buffers. These may include stabilization funds, countercyclical fiscal rules, and flexible exchange rate regimes. Such tools can help absorb external shocks without resorting to inflationary measures, thereby preserving macroeconomic stability in turbulent times.

Taken together, these policy recommendations highlight the importance of institutional quality, strategic foresight, and coordinated action in managing the complex interplay between fiscal policy and inflation in Latin America.

6. Conclusion

This study provides robust evidence that fiscal policy has been a key driver of inflation in Latin America during the post-pandemic period. While the findings align with those observed in advanced economies, the Latin American context introduces unique challenges related to fiscal credibility, institutional quality, and external vulnerability. The strong and persistent link between government spending and inflation underscores the need for prudent fiscal management and coordinated macroeconomic policies.

Future research should explore the role of political economy factors, such as electoral cycles and populist pressures, in shaping fiscal behavior. Additionally, more granular data on debt composition and investor expectations could shed light on the transmission mechanisms linking fiscal policy to inflation. Ultimately, understanding these dynamics is essential for designing policies that promote both macroeconomic stability and inclusive growth in the region.

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Annex

Other variables tested in the dynamic panel regression.

This annex presents the summary of other variables tested in the dynamic panel regression presented in Table 7. Data on COVID-19-related deaths comes from the World Health Organization's COVID-19 data dashboard, and the OXSI index is sourced from Oxford University Blavatnik School of Government. Trade openness data is calculated as the sum of the value in US dollars of all imports and all exports of a specific country and is transformed using the natural logarithm; data are from the IMF's Balance of Payments statistics. Commodity-related data are sourced from the World Bank's Commodity Price Data (Pink Sheet). Financial account and financial flows data come from the IMF's Balance of Payments statistics. Exchange rate data is from the IMF's IFS database. Fiscal variables considered in this annex are sourced from S&P's Capital IQ, and both offered and issued debt are transformed using the natural logarithm. Institutional quality data are from the World Bank's Worldwide Governance Indicators.

Table 9. Control Variables Description

Variable	*Description*
Other Controls	
Covid-19 Pandemic	
Covid	Dummy = 1 for 2020, 2021, 2022 & 2023, = 0 otherwise.
Covid Deaths	Covid-19 related deaths by country, per 1 million people.
Covid Deaths x Expenditure	Interaction between primary government expenditure and Covid-19 related deaths.
OXSI	Oxford Covid-19 Government Response Tracker tracks individual policy measures across 21 indicators.
Trade	
Trade Openness	Natural logarithm of the annual Exports + Imports in USD.
Commodities	
Oil Avg	Natural logarithm of the price per barrel, average spot price of Brent, Dubai and West Texas Intermediate, equally weighed.
Oil WTI	Natural logarithm of the price per barrel, WTI spot price.
All-commodities	Index considering the price of all commodities.
Precious Metals Index	Index considering the prices of Gold, Silver and Platinum.
Financial	
Financial Account	Financial account balance of the considered economies, during the specified period for the dynamic panel regressions.
Financial Flows	Financial flows total in the considered economies.
Country Specific	
Exchange Rate	Natural logarithm of the nominal exchange rate, National currency per US Dollar.
Country Dummy	Dummy = 1 for specific country, = 0 for other countries.
Fiscal	
Offering Debt	Natural logarithm of the issued government debt in USD reported in Capital IQ, sum by year.
Issued Debt	Natural logarithm of the issued government debt in USD reported in Capital IQ and national sources, sum by year.
S	Simple average of the duration of government issued debt.

Table 9. Control Variables Description (continuation)

Variable	*Description*
Other Controls	
Institutional	
Government Effectiveness	Captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
Political Stability	Measures perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism.
Regulatory Quality	Captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.
Rule of Law	Captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.
Voice and Accountability	Captures perceptions of the extent to which a country's citizens can participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.
Control of Corruption	Captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.

FLAR
FONDO LATINOAMERICANO DE RESERVAS

Fondo Latinoamericano de Reservas | FLAR
Calle 84A No. 12-18 Piso 7 | Bogotá, Colombia
Correo electrónico: flar@flar.net
Tel: (571) 634 4360