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FISCAL POLICY AND PUBLIC DEBT IN MERCOSUR COUNTRIES: AN ANALYSIS FOR THE PERIOD 2000-2024

Política Fiscal e Dívida Pública nos Países do Mercosul: Uma Análise Para O Período 2000-2024

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RESUMO

Este artigo analisa a dinâmica da dívida nos países do MERCOSUL de 2000 a 2024, identificando duas trajetórias distintas. O primeiro período (até 2010) mostrou melhora nos indicadores fiscais e estabilização da dívida, apoiado por condições externas favoráveis e preços de commodities. Os países implementaram regras fiscais para controlar gastos e dívidas. O segundo período (a partir de 2011) enfrentou múltiplos desafios, incluindo a crise financeira de 2008/2009, a crise da zona do euro e a pandemia da COVID-19, levando ao aumento da incerteza, inflação e taxas de juros. Isso afetou negativamente o crescimento e aumentou o endividamento nos membros do MERCOSUL, exigindo reformulação das regras fiscais. A pesquisa revela que esses países carecem de mecanismos eficazes para enfrentar os desafios fiscais cíclicos e os problemas estruturais, incluindo questões emergentes como as mudanças climáticas, que exigem investimentos substanciais para adaptação e mitigação.

Palavras-chave: Dívida Pública; Regras Fiscais; Desenvolvimento Econômico; MERCOSUL.

JEL: E62, H61, H63, O11, F15.

ABSTRACT

This paper analyzes debt dynamics in MERCOSUR countries from 2000 to 2024, identifying two distinct trajectories. The first period (until 2010) showed improvement in fiscal indicators and debt stabilization, supported by favorable external conditions and commodity prices. Countries implemented fiscal rules to control spending and debt. The second period (from 2011) faced multiple challenges, including the 2008/2009 financial crisis, Eurozone crisis, and COVID-19 pandemic, leading to increased uncertainty, inflation, and interest rates. This adversely affected growth and increased indebtedness in MERCOSUR members, requiring fiscal rules reformulation. The research reveals that these countries lack effective mechanisms to address cyclical fiscal challenges and structural problems, including emerging issues like climate change, which requires substantial investment for adaptation and mitigation.

Keywords: Public debt; Fiscal rules; Economic development; MERCOSUR

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1. Introduction

In recent decades, developing countries have faced economic liberalization processes - both commercial and financial - with significant implications for macroeconomic policy management.

Regarding fiscal policy, the establishment of "responsible" rules and institutions to discipline the conduct of public budget managers was widely recommended, under the justification that they would act to validate economic agents' expectations regarding public debt sustainability, creating an environment conducive to investment, resulting in economic growth in the medium and long term.

The favorable scenario of the 2000s, marked by China's rise and the commodities price boom, facilitated the adoption and even temporary compliance with rules and, in general, MERCOSUR countries experienced relative improvement in fiscal indicators and debt rate stability. However, with the changing scenario after the 2008 financial crisis, the situation shifted. The aftermath of this crisis and other adverse shocks that hit the world economy since the late 2000s brought difficulties to countries, especially developing ones. In Latin America, deteriorating terms of trade, the return of inflation, and high interest rates were responsible for worsening fiscal indicators and increasing public debt and its "rollover" cost. In this context, fiscal rules had to be rethought, including mechanisms capable of addressing the adverse effects of economic cycles.

This article aims to analyze debt dynamics in MERCOSUR countries - Brazil, Argentina, Paraguay, and Uruguay - from 2000 to 2024. We chose not to analyze Venezuela due to factors including lack of confidence in the reported data, absence of recent data from 2023 onwards, and also due to Venezuela's suspension from MERCOSUR. After a brief theoretical discussion on fiscal regimes and contextualization of the public debt landscape in the global economy, we move to a more specific analysis of the debt trajectory of each MERCOSUR country. Despite marked differences, points of convergence can be observed among the bloc's economies, such as vulnerability to external shocks, structural problems characterizing various fields - economic, social, environmental - as well as difficulties in implementing and improving instruments related to enhancing public spending quality, coherence and efficiency of the revenue structure, and public debt management.

The main research findings indicated that MERCOSUR countries lack more effective mechanisms to deal with cyclical fiscal challenges, recently aggravated by economic, social, and environmental issues. Furthermore, it is crucial that these countries find joint solutions and act in a coordinated manner to address structural problems, both old and current, such as the climate crisis, which demands significant investments for mitigating and adapting to its effects.

2. Fiscal Regimes: Concepts, Typologies, and the Rules versus Activism Debate

2.1 Ricardian and Non-Ricardian Regimes

The conduct of fiscal policy, broadly speaking, is divided into two opposing perspectives: Ricardian and non-Ricardian regimes.

The concept of Ricardian regimes derives from a well-established principle in economics - Ricardian Equivalence. According to this principle, regardless of how the government finances its debt, whether through money creation or issuance of government securities, there will be a future

tax increase to balance public accounts. Thus, economic agents, being rational, anticipate this movement, adjusting preventively by reducing consumption and/or investment, while simultaneously increasing savings to accommodate higher future tax payments, such that the result of an expansionary fiscal policy would have null effects on income. In view of this, the government should conduct fiscal policy in a "disciplined" manner, adjusting its primary balance to stabilize public debt trajectory, ensuring the economy's solvency (AFONSO, 2008).

An important aspect of Ricardian regimes is the emphasis on budgetary rigidity, often supported by imposing rules for public budget execution. The normative framework aims to ensure the intertemporal sustainability of government finances, controlling public debt trajectory to maintain it at levels considered adequate. According to Dweck and Teixeira (2017), this stance is reinforced by the "expansionary fiscal contraction" thesis, according to which a fiscal contraction policy not only does not reduce but can even stimulate economic growth, given the positive effects on agent confidence, impacting investments and growth.

Regarding the historical context, the adoption of fiscal rules gained relevance from the 1990s, when various countries began implementing standards to restrict discretion, increase public accounts transparency, and establish clear guidelines for economic policymakers (ELBADAWI; SCHMIDT-HEBBEL; SOTO, 2015). These authors emphasize that, beyond these objectives, fiscal rules also contributed to mitigating fiscal policy pro-cyclicality, strengthening resilience against government corruption, and reducing private sector lobby influence.

In developing countries, the adoption of fiscal rules had even stronger motivation. After the external debt crisis of the 1980s and these countries' return to international financial markets, fiscal management began to act as a kind of "anchor," signaling lower default risk for those economies. Additionally, compliance with rules would enable reducing country risk, improving rating agency assessments, and reducing risk premiums, creating more favorable conditions for economic growth (LOPREATO, 2006).

Conceptually, a fiscal rule consists of a permanent restriction imposed on a country's fiscal policy conduct, defining limits for certain economic aggregates (OKWUOKEI, 2014). Among the main fiscal rules are:

1. Public debt rules: establish limits for public debt growth relative to GDP, ensuring convergence to sustainable levels;
2. Budget balance rules: define the balance between public budget revenues and expenditures, potentially referring to general, structural, or cyclically adjusted balance, which captures fiscal policy changes unrelated to economic cycle effects on the budget; thus, a "throughout the cycle" rule defines achieving a nominal balance, on average, throughout the cycle;
3. Expenditure rules: limit government spending related to total, primary, or current deficits, a restriction that can be in absolute terms, growth terms, or GDP percentages;
4. Revenue rules: set minimum or maximum limits for tax collection.

These fiscal rules were widely adopted in both developed and developing countries. Examples include the Maastricht Treaty (1992), which established limits for public deficit and debt relative to GDP in the European Union, and later, the Stability and Growth Pact (1997) and the "Six-Pack Reforms" (2012). Groups of countries in Africa and Latin America also adopted various formats of fiscal restrictions in the 2000s (SCHAECHTER et al., 2012). In Brazil, notable examples include: primary surplus targets (1998-2015), spending ceiling (2016-2022), and the new fiscal framework from 2023.

On the other hand, non-Ricardian regimes are characterized by the government's (or National Treasury's) lack of commitment to intertemporal balance of public finances, meaning there is no explicit concern in matching current debt with future tax revenue flows, discounted to present

value. They rely on fiscal discretion, prioritizing employment and income promotion and smoothing typical economic cycles of capitalist economies. In this mode of operation, fiscal policy does not aim to meet an intertemporal constraint; the government defines primary results without necessarily considering public debt, prioritizing other macroeconomic objectives it considers more relevant. Although public finance sustainability can be achieved in this regime, it is not necessarily linked to an intertemporal constraint (AFONSO, 2008).

For Dweck and Teixeira (2017), this regime assumes that public spending plays a central role in growth, with fiscal policy being actively conducted to stimulate private investments, guide expectations, and reduce uncertainties. Based on important principles in macroeconomics, such as the Keynesian multiplier, it postulates that public spending acts as an inducer of private investment. Moreover, during crisis moments, countercyclical fiscal policy is essential to restore demand levels, thus avoiding crisis deepening (TCHERNEVA, 2011).

2.2 The Debate on Discretion versus Fiscal Rules

Regarding the effects of adopting fiscal rules, evidence from empirical literature has been controversial. The seminal study by Alesina and Tabellini (1990) and Alesina and Perotti (1995) suggested, in a cross-country analysis, that episodes of fiscal adjustment were followed by increased economic growth, supporting the "expansionary fiscal contraction" thesis. Similarly, Reinhart and Rogoff (2010) investigated public debt limits beyond which growth would be impaired; however, their study was later challenged due to database and methodological flaws (HERDON; ASH; POLLIN, 2013).

These works reinforced the idea of the superiority of rule-based fiscal regimes, being corroborated by several other recent studies (BERGMAN; HUTCHISON; JENSE, 2016; CASELLI; REYNAUD, 2019; CHRYSANTHAKOPOULOS; TAGKALAKIS, 2023). Among the main aspects emphasized for adopting fiscal rules are the importance of adopting credible rules; the need for appropriate institutionality and/or design for fiscal rule(s); creating legislative apparatus to support established norms; establishing fiscal councils; clarity and realistic publicity of fiscal indicators, among other aspects. Another argument against discretion and in favor of rules is the idea of fiscal dominance, which suggests that excess public spending will result in future inflation. This is because if the government overspends in the present, higher interest rates will apply to government securities, making debt "rollover" more expensive and forcing the government to resort to seigniorage, leading to inflation (LOPREATO, 2006).

On the other hand, various works have been developed bringing a critical perspective around the nature of fiscal rules and their inability to deal with development challenges. In particular, there is questioning about the lack of clarity surrounding the empirical relationship between robust fiscal surplus policies and low debt and economic growth. Indeed, it is questioned whether these policies actually lead to economic growth, or if the causality is reverse (DAFERMOS, 2015). Additionally, other criticisms argue that this conduct has proven inconsistent with dealing with relevant and urgent requirements of the contemporary world, such as energy transition, new industrial policies, defense spending, social policies, among many other challenges (CASELLI; LAGERBORG; MEDAS, 2024).

In line with different approaches, where Ricardian and non-Ricardian regimes are associated with the extremes of rules of conduct or discretion, new situations highlight a new format of hybrid regimes, that is, combining elements from both approaches, adapting to specific country needs and economic context. Schaechter (2012) discusses that the generation of fiscal rules that emerged after the 2008 crisis, despite some countries having escape clauses in abnormal situations, began to explicitly combine sustainability with flexibility to cope with economic shocks that might affect

economies. Among the changes, structural budget balance can be highlighted, defined in adjusted terms to take into account the effects of economic cycles on public finances.

3. Literature Review and Global Historical Context (2000-2024)

The global context from the 2000s was marked by various significant events, featuring periods of growth but also multiple crises of economic-financial nature, military conflicts, and even health crises.

According to Schaechter (2012), fiscal rules spread in three distinct phases. The first began in the 1990s, partly in response to banking and sovereign debt crises in some countries, including actions required for European countries to join the euro area. The second wave occurred in the 2000s, mainly in developing economies, when the adoption of rules aimed to reverse a history of high deficits and budgetary lack of control, in a context of greater integration of world markets. The third wave emerged after the global financial crisis (GFC) of 2007/2008, when various countries, in response to the crisis, began modifying their fiscal rule frameworks, typically combining sustainability objectives with flexibility, introducing rules that incorporated economic cycle effects.

It should be noted that in the early 2000s, the world economy experienced an expansion phase motivated primarily by China's rise as a major player in the international scenario, with positive impacts on the performance of developing countries, notably commodity suppliers - food, industrial inputs, and energy (Castro, 2008). These transformations led to a phase of relative macroeconomic stability, and in this scenario, fiscal policies were generally predominantly conservative, both in advanced and peripheral countries. Broadly speaking, the trend was toward reduction of public debt and greater budgetary balance. As shown in Graph 1, from the early 2000s until the 2008 crisis (GFC), in developing countries, including Latin America, primary surpluses were considerable, while in advanced economies, there was alternation between years of small deficit and periods of surplus.

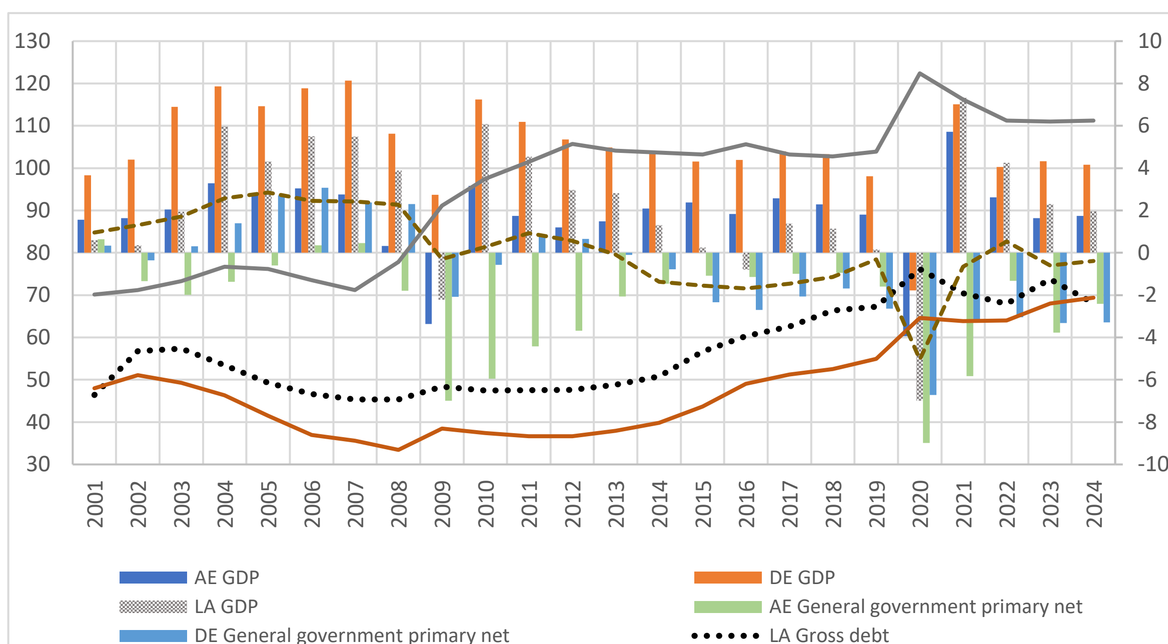

Figure 1 – GDP (%) and Fiscal Indicators in Advanced Economies (AE), Developing Economies (DE) and Latin America (LA), in % of GDP, 2001-2024*
Source: IMF/WEO (2024)
Note: 2024 estimates.

This situation changed after the 2008 Crisis. A country's fiscal response to the crisis required the adoption of expansionary fiscal policies. Various countercyclical policies have been implemented worldwide, such as temporary tax cuts, reinforced benefit payments such as unemployment insurance, and even the resumption of public works investments. As Lavoie and Seccareccia (2017) highlight, this phase marked the beginning of a fiscal policy transformation called New Fiscalism, referring to a change in vision regarding the role of fiscal policy that must, in fact, be actively conducted in crisis contexts, so that policymakers achieve a greater degree of fiscal policy pragmatism, based on the functionality of public deficits to stabilize the economy.

A significant increase in sovereign debt is noted in the context of the crisis. As Graph 1 illustrates, public debt in developed economies grew by 20 percentage points in just two years, rising from 71.16% of GDP in 2007 to 91.10% of GDP in 2009, on average. Furthermore, it continued to grow until 2012, stabilizing only afterward. Importantly, the Eurozone countries' crises reinforced the recessionary context. This crisis exposed the region's fragility through the downgrading of some countries by rating agencies due to excessive indebtedness and high fiscal deficits of the so-called PIIGS – Portugal, Ireland, Italy, Greece, and Spain (IMF, 2011). Parallel to the worsening fiscal situation, GDP was negative in 2008 and 2009, maintaining a low and even negative growth trajectory up to 2014.

With regard to developing economies, including Latin America, public debt growth occurred more slowly, but expanded continuously throughout the analyzed period. Following the same trend, the deterioration of government primary balances has gradually increased since the GFC episode, a scenario accompanied by lower economic growth rates.

After the acute phase of the GFC, most economies, mainly advanced economies, returned to fiscal consolidation processes. Despite near-zero interest rates, public debt followed an upward trajectory, and primary deficits remained high until around 2013, stabilizing thereafter. The debate around austerity returned to the world stage with the emergence of new fiscal paradigms, mainly through more flexible rules adjusted to the economic cycle. An example occurred in Eurozone

countries where, in an attempt to reduce the deficit trajectory and public debt, many economies combined fiscal rules with adjustments resuming post-crisis discipline (IMF, 2022).

This scenario was interrupted by the COVID-19 pandemic and its impacts (March/2020-May/2023). Countries, both developed and developing, have adopted policies to enable population access to vaccines, protect family income and business survival, and experience strong fiscal expansions, with rising primary deficits and escalating public debt. Even before recovery, economies faced other urgent challenges, including substantial volumes allocated to energy transition support packages and spending in response to Ukrainian war developments, mainly in Europe. Notably, worldwide inflation resurgence has led to an increase in interest rates, resulting in low dynamism of the world economy, expanding uncertainties, and making debt rollover even more onerous, especially in developing countries (IMF, 2022).

Finally, as discussed by CEPAL (2024), since 2022, the U.S. Since 2023, the European Central Bank (ECB) and the Bank of England halted quantitative easing policies and initiated a quantitative tightening trajectory at a restriction level not seen since the 2008 financial crisis, explained by the persistent inflationary trajectory of recent years. Debt in developed countries has increased, and in developing countries, public debt has also been expanding in a trajectory similar to that observed in MERCOSUR countries, as will be discussed next.

4. Analysis of Public Debt in MERCOSUR

The global macroeconomic scenario that emerged after the global financial crisis has shown great complexity, affecting the fiscal performance and debt levels in the Latin American region. The analysis of public debt in MERCOSUR is a part of the global context of increasing indebtedness. According to UNCTAD (2024) data, global public debt will reach US$ 97 trillion in 2023, an increase of US$ 5.6 trillion compared to 2022. This growth has been particularly pronounced in developing countries, where the pace of debt expansion is twice that of the developed countries. This global trend helps contextualize the specific challenges faced by MERCOSUR countries.

Another concern is that according to CEPAL (2023), since 2022, the U.S. Since 2023, the European Central Bank (ECB) and Bank of England have initiated an unprecedented quantitative tightening trajectory since the 2008 financial crisis. Quantitative tightening policies have been a key factor in the evolution of global liquidity and the rise in short- and long-term interest rates. This scenario has significantly impacted MERCOSUR countries, particularly through increased external financing costs.

According to CEPAL (2023), a relevant factor is the prolonged deceleration of economic activity, which between 2010-2024 showed an average rate of approximately 1.6%. This is compounded by falling commodity prices that negatively affect tax revenues. On the expenditure side, pressure on public spending remains for various reasons, including social and environmental issues. This scenario is aggravated by high interest rates in international and domestic financial markets, which increases interest costs on public debt.

The pressure on public debt in this region reflects the broader pattern observed in developing countries. According to UNCTAD (2024), there has been a significant increase in financing costs, with interest rates for developing countries being two to four times higher than those of the United States and six to 12 times higher than those of Germany. This disparity in financing costs has a direct impact on the debt management capacity of the MERCOSUR countries.

Given the described scenario, the public debt trajectory in MERCOSUR countries presents distinct characteristics among its members but with some common patterns that deserve highlighting

throughout the 2000-2024 period. Figure 2 shows the evolution of Gross Debt as a proportion of the GDP for each MERCOSUR country.

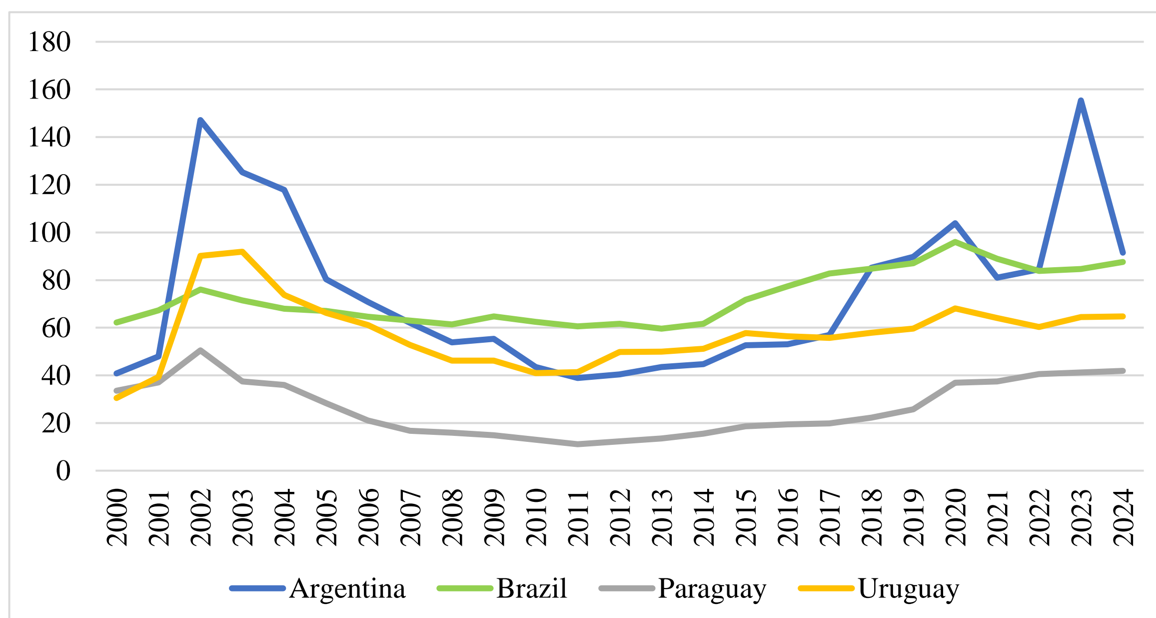

Figure 02: Evolution of Debt as a proportion of GDP (%) of MERCOSUR Member States from 2000 to 2024.
Source: World Economic Outlook - IMF (2024). * The Bolivarian Republic of Venezuela is suspended in all the rights and obligations inherent to its status as a State Party of MERCOSUR, in accordance with the provisions of the second paragraph of the Article 5 of the Protocol of Ushuaia.

4.1 Brazil

Brazil has one of the most complex debt trajectories in the MERCOSUR region. According to Figure 2, the 2000-2014 period was characterized by relative stability, with public debt fluctuating around 60-65% of GDP. This stability was mainly sustained by consistent primary surplus generation and a more favorable macroeconomic environment, especially during the commodity boom.

However, from 2015 onwards, an important structural change was observed in Brazil's debt trajectory. The country began a trend of a more pronounced debt increase, which was later aggravated by the Covid-19 crisis. According to Powell and Valencia (2022), as part of the group of diversified economies, Brazil saw its debt exceeding 80% of GDP during the pandemic, representing one of the largest debt jumps in recent history. The same authors reveal important aspects of the Brazilian debt composition. Brazil has a peculiar debt structure with a significant proportion of securities linked to the SELIC rate and inflation. This composition makes debt costs particularly sensitive to changes in monetary policy and price levels. Moreover, unlike other countries in the region, Brazil maintains its debt in the local currency, which reduces its direct exposure to exchange rate shocks. However, this characteristic also generally implies higher carrying costs, given the differential between domestic and international interest rates.

The pressure of interest payments on the public budget, highlighted by UNCTAD (2024), is particularly relevant in Brazil. The report indicates that developing countries are allocating an increasing share of their revenues to interest payments, often exceeding the essential spending in areas such as health and education.

Various structural factors have contributed to Brazilian debt dynamics. First, as pointed out by Powell and Valencia (2022) and UNCTAD (2024), the country faces significant budgetary rigidity, with high participation in mandatory spending that limits its fiscal adjustment capacity. This

rigidity manifests in both current expenditures and constitutional revenue earmarking. According to the authors, Brazil has experienced below-potential economic growth in recent years, making it difficult to generate the necessary revenues to stabilize the debt/GDP ratio. The combination of low growth and rigid spending has consistently pressured public accounts.

However, this prospective scenario presents a significant challenge. According to Powell and Valencia (2022), Brazil would need to generate consistent primary surpluses of about 1.5% of GDP in the coming years to converge to more prudent debt levels, estimated at around 54% of GDP. The authors also point out that the country faces the challenge of reconciling the need for fiscal consolidation with the demands for public investments and social spending. Along these same lines, the authors argue that Brazil needs to not only stabilize but also reduce its debt to safer levels, which will require significant structural reforms and a lasting commitment to fiscal discipline. The analysis suggests that success in Brazilian debt management crucially depends on the country's capacity to implement reforms that increase budgetary flexibility, improve public spending efficiency, and promote a more favorable environment for sustained economic growth. In particular, the authors advocate strengthening the fiscal framework and improving public spending quality as essential elements for a more sustainable trajectory of Brazilian public debt over the long term.

Another important factor is the economic activity slowdown observed in the region, as pointed out by CEPAL (2023), which has contributed to further pressure on Brazil's fiscal situation. Lower economic growth, resulting from a more restrictive monetary policy to control inflation and weakened external impulses, has negatively impacted tax collection, hindering the fiscal consolidation process. In the second quarter of 2023, the region's economy recorded a growth of only 2%, reflecting the weakening of both domestic demand and external contributions.

It should be noted that, in Brazil's case, institutional changes in recent years, including the Independent Central Bank and systematic reduction of inflation targets between 2018 and 2024, reducing them from 4.5% to 3% annually, with a 1.5% tolerance interval, have made monetary policy more restrictive, keeping Brazil second in the ranking of countries with the highest real interest rates in the world, behind Turkey, despite the improvement in various macroeconomic indicators. This regulatory-institutional panorama has been undermining the possibilities of political solutions to the problem, making it merely a "technical issue' (PAULANI 2024). This fact has greatly hindered the resolution of the fiscal issue, as indicated by deficit and public debt indicators in recent years.

4.2 Argentina

Argentina is one of the most emblematic cases of public debt instability in MERCOSUR. As Figure 02, Argentina faced multiple debt crises that resulted in defaults and restructuring. The most severe crisis occurred in the early 2000s, when the collapse of the convertibility regime and subsequent peso devaluation led public debt to peak, exceeding 140% of GDP.

According to Powell and Valencia (2022), Argentina's debt trajectory is marked by cycles of strong accumulation, followed by episodes of default or forced debt restructuring, primarily external debt. These recurring crises are frequently accompanied by severe currency devaluations, which amplify their impact on foreign currency-denominated debt.

The most recent Argentine debt restructuring process, as detailed by Powell and Valencia (2022), occurred after the 2018-2019 crisis, when the country faced renewed loss of access to international markets. This restructuring involved complex negotiations with private creditors and the IMF, seeking term extensions and reducing financial charges. The authors also highlight that, unlike previous restructurings, the most recent episode occurred in the context of historically low international interest rates, which could theoretically facilitate recovery. However, the outbreak of

the Covid-19 pandemic significantly complicated the process of normalizing relationships with creditors.

The prospects for Argentine public debt present significant and complex challenges that require substantial effort. According to Powell and Valencia (2022), even considering a relatively optimistic baseline scenario, a country will face considerable obstacles in making its debt converge to safer levels of indebtedness, making the future outlook particularly challenging. The authors also identified several critical factors that need to be addressed for the country to establish a more sustainable trajectory of public debt. The first is the urgent need to rebuild the country's fiscal and monetary credibility, which is severely shaken after successive crises. Simultaneously, Argentina must face the structural challenge of reducing its historical dependence on foreign currency financing, which has proven to be a recurring source of vulnerability during turbulent times in international markets. The Argentine case illustrates the broader challenges faced by developing countries in terms of accessing international financing. According to UNCTAD (2024), in 2022, developing countries paid US$ 49 billion more to their external creditors than they received in new disbursements, resulting in a negative net resource transfer. This dynamic is particularly relevant in Argentina, which faces recurring difficulties in accessing international markets.

Another crucial element pointed out by Powell and Valencia (2022) is the importance of developing a deeper and more liquid domestic debt market that can offer viable financing alternatives in the local currency. This development needs to be accompanied by comprehensive structural reforms that raise the potential growth of the Argentine economy, thus creating more favorable conditions for debt sustainability in the long term. To achieve a truly sustainable trajectory, the authors indicated that Argentina would need to generate primary surpluses consistently higher than its historical average, an objective that would demand an unprecedented level of political and social consensus in the country. This need for significant surpluses becomes even more challenging, considering the history of political polarization and social resistance to deeper fiscal adjustments.

Finally, Powell and Valencia (2022) show that the success of future Argentine debt management will fundamentally depend on the country's ability to break with its historical pattern of crisis-restructuring-crisis cycles, which has characterized its economic trajectory in recent decades. This break will require not only the implementation of consistent macroeconomic adjustments, but also the realization of profound institutional reforms that can ensure greater predictability and credibility of the country's economic policy in the long term. Only with this comprehensive set of changes will it be possible to envision a future with greater stability for Argentine public debt.

4.3 Uruguay

Uruguay presents remarkable experience in public debt management, which can be divided into two distinct periods. As pointed out by Powell and Valencia (2022), the country faced high levels of indebtedness in the early 2000s, reaching levels of concern during the regional crisis that also affected Argentina and Brazil. However, the country stands out for its successful implementation of a comprehensive debt management strategy that includes not only fiscal consolidation measures but also important reforms in the fiscal governance structure.

The Uruguayan fiscal reform process is particularly interesting because of its comprehensiveness and consistency over time. As Powell and Valencia (2022) show, Uruguay implemented a series of structural reforms that significantly strengthened its fiscal framework. Among the main measures, the adoption of more robust fiscal rules, strengthening of public account transparency, and improvement in public spending control mechanisms stand out. A crucial aspect

of these reforms was building political and social consensus around the importance of fiscal responsibility, which allowed their continuity, even during periods of political alternation.

The results of the reforms implemented by Uruguay are significant. Powell and Valencia (2022) highlight that the country managed to stabilize its debt at intermediate levels, between 60-70% of GDP, demonstrating greater resilience to external shocks compared to its MERCOSUR neighbors. This stabilization was achieved through the consistent generation of primary surpluses and improvement in debt composition, with greater participation of local currency instruments and longer terms.

Particularly notable was The country's response to the Covid-19 crisis. As evidenced by Powell and Valencia (2022), even during the pandemic, the increase in Uruguayan debt was more moderate than in other countries in the region, demonstrating the effectiveness of the implemented reforms and the greater robustness of its fiscal framework. The country managed to maintain access to international markets under relatively favorable conditions, even in the context of strong global turbulence.

The prospects for Uruguayan public debt are relatively favorable, although important challenges remain. According to projections presented by Powell and Valencia (2022), the country is able to maintain a sustainable debt trajectory, provided it maintains a commitment to fiscal discipline and continues to advance its structural reforms. The authors identified the need to continue strengthening the domestic debt market, gradually reducing economic dollarization, and facing growing fiscal pressures related to population aging as the main future challenges. Additionally, the country will need to balance the need to maintain fiscal prudence with demands for greater investments in infrastructure and social spending.

However, Uruguay's historical success in implementing and maintaining fiscal reforms, along with its demonstrated ability to build political consensus around fiscal objectives, suggests that the country is well-positioned to face these challenges. The Uruguayan experience offers lessons for other countries in the region regarding the importance of combining structural reforms with a consistent commitment to fiscal responsibility.

4.4 Paraguay

Paraguay presents a notably conservative debt profile in the regional context. As shown in Figure 02, the country consistently maintained the lowest debt level among all MERCOSUR members, with a trajectory that remained stable and controlled, consistently remaining below 40% of GDP throughout the analyzed period. This characteristic is particularly relevant when compared to its neighbors, which showed significantly higher and more volatile debt levels.

The Paraguayan fiscal policy in recent years has stood out for its prudence and consistency. As pointed out by Powell and Valencia (2022), even during the Covid-19 crisis, when several countries in the region significantly expanded their public spending, Paraguay maintained a more measured stance, resulting in a greater increase in debt compared to its neighbors. The fiscal response to the pandemic was calibrated to offer the necessary support to the economy without compromising long-term fiscal sustainability.

The analysis presented by Powell and Valencia (2022) demonstrates that the country has managed to maintain a consistent fiscal policy over time, benefiting from more prudent macroeconomic management and an institutional framework that favors fiscal discipline. Paraguay has been able to generate primary surpluses with relative regularity, which contributes to the maintenance of controlled debt levels.

Despite its success in debt management, Paraguay has faced significant structural challenges. Powell and Valencia (2022) highlight that the country still needs to deal with important bottlenecks in infrastructure and social development that will require substantial public resources in coming years. The major challenge is reconciling these investment needs while maintaining the fiscal discipline that characterizes its macroeconomic management. Additionally, the authors point out that a country needs to strengthen its tax base and diversify its productive structure to reduce its vulnerability to external shocks. The dependence on agricultural commodities and hydroelectric power makes the Paraguayan economy susceptible to fluctuations in international prices and adverse weather conditions.

The projections presented by Powell and Valencia (2022) suggest a relatively favorable scenario for Paraguayan public debt. The model indicates that by maintaining current fiscal management characteristics, the country should be able to preserve debt levels significantly below the regional average. However, these projections are conditional on maintaining fiscal discipline and the country's capacity to face structural challenges without compromising public account sustainability. The authors also emphasize that the future of Paraguayan fiscal management will depend on its ability to balance competing demands: on the one hand, the need to maintain fiscal prudence that has characterized its recent trajectory; on the other hand, the urgency of investments in critical areas for the country's economic and social development. This balance is fundamental for Paraguay to preserve its differentiated position in a regional context in terms of public debt management.

5. Comparative Analysis and Implications

5.1 Common Patterns

The data analysis reveals striking trends that characterize the evolution of public debt in MERCOSUR. The first significant trend, as documented by Powell and Valencia (2022), was the unprecedented impact of the Covid-19 pandemic on regional public finance. Governments have implemented emergency fiscal packages that represent 8.5% of GDP on average, resulting in a substantial increase in debt levels. This shock was particularly significant, raising the region's average debt from 58% to 72% of the GDP between 2019 and 2020.

The differentiated impact of restrictive monetary policies among MERCOSUR countries reflects the broader pattern observed in Latin America. According to CEPAL (2023), this slowdown has been more pronounced in South America than in Mexico and Central America. In the case of MERCOSUR countries, this dynamic is even more pronounced when Brazil is excluded from the analysis, highlighting distinct structural vulnerabilities among bloc members. Lower economic dynamism has been reflected, especially in the industrial and manufacturing sectors, with direct impacts on the capacity to generate fiscal revenue.

Another important regional trend is the similar responses of countries to major external shocks. The 2008-2009 global financial crisis and subsequent fall in commodity prices caused significant deterioration in the public accounts of all bloc members, albeit with varying intensities. This behavior reflects a structural characteristic of the region: its strong dependence on international trade and, in particular, commodity exports.

Powell and Valencia (2022) identify several vulnerabilities common to MERCOSUR countries. The main challenge, as highlighted by the authors, is debt sustainability. All bloc countries must make considerable fiscal consolidation efforts in the coming years to achieve more prudent debt levels. The authors suggest that an additional average fiscal effort of 1.5% of the GDP per year

would be necessary over the next decade to achieve these objectives. The second shared vulnerability is the sensitivity to fluctuations in international financial conditions. Powell and Valencia (2022) showed how changes in global interest rates and risk perceptions significantly affect the cost and availability of financing for all countries in the region, albeit to different degrees. This vulnerability is amplified by the significant participation of foreign currency debts in most countries.

Additionally, Powell and Valencia (2022) pointed out various opportunities for regional cooperation that could strengthen public debt management in MERCOSUR. A promising area is the sharing of successful fiscal and institutional reforms. Uruguay's case, for example, offers valuable lessons on implementing gradual and consistent fiscal reforms, while Paraguay's experience demonstrates the importance of fiscal prudence, even in moments of pressure for spending expansion. Another significant opportunity is the development of regional fiscal coordination mechanisms. The authors suggest that greater harmonization of fiscal policies could reduce external vulnerabilities and strengthen the bloc's negotiating position in international markets. Furthermore, the creation of regional financing instruments and deepening of local debt markets are identified as promising paths to reduce dependence on external financing.

Finally, Powell and Valencia (2022) emphasize that taking advantage of these cooperation opportunities will be fundamental in strengthening the fiscal resilience of the region as a whole. Historical experience demonstrates that despite differences between countries, shared challenges create a strong incentive to seek coordinated solutions. Future success in MERCOSUR public debt management will largely depend on countries' capacity to leverage these cooperation opportunities while maintaining commitment to individual fiscal discipline.

5.2 Future Challenges

One of the main challenges for the future fiscal sustainability of MERCOSUR countries is demographic pressure. As Powell and Valencia (2022) point out, population aging generates increasing fiscal demand, especially in terms of health and pension expenditures. Countries such as Uruguay, which has managed to maintain a sustainable debt trajectory, will need to balance these pressures with the need to preserve fiscal prudence. This will require reforms in pension and health systems to ensure long-term sustainability without compromising other essential investments.

Another critical challenge is the need to invest in infrastructure and social development. Powell and Valencia (2022) highlight those countries like Paraguay, despite success in debt management, still face significant bottlenecks in these areas. It will be fundamental to reconcile these investment demands while maintaining the fiscal discipline that has characterized recent Paraguayan macroeconomic management. For countries with higher debt levels, such as Brazil and Argentina, this challenge is even greater, as it requires finding fiscal space in the context of budgetary constraints.

The deterioration of external conditions identified by CEPAL (2023) represents an additional challenge for public debt management in the MERCOSUR countries. The moderation of global economic activity, which is particularly important in China, has affected commodity prices, an important source of revenue for several countries. Additionally, rising international interest rates have increased external debt service costs. The contraction of bank credit observed in both the Eurozone and the United States suggests that these restrictive conditions should persist, demanding even more significant fiscal adjustments from bloc countries.

Climate change also imposes additional challenges to the fiscal sustainability of the region. More frequent extreme weather events tend to pressure public spending through mitigation actions, adaptation, or disaster response. At the same time, the transition to low-carbon economies requires

significant public and private investments. Balancing these needs with fiscal constraints is a test for policymakers.

Given these challenges, some trends and vulnerabilities common to block countries have already been addressed. The Covid-19 pandemic led to a substantial increase in debt levels, raising MERCOSUR's average debt from 58% to 72% of the GDP between 2019 and 2020. This situation amplifies the need for fiscal consolidation efforts in the coming years to return debt to more prudent levels. Another vulnerability factor is bloc countries' sensitivity to external shocks and fluctuations in international financial conditions given the weight of foreign currency debt in the composition of various countries' indebtedness. Therefore, strengthening domestic fiscal fundamentals and developing local debt markets are important actions to reduce this exposure.

Finally, opportunities for regional cooperation can contribute to addressing these common fiscal challenges. Sharing successful reform experiences, greater coordination of macroeconomic policies, and the development of joint financial instruments are some of the paths indicated. History shows that despite differences between countries, shared challenges create incentives to seek coordinated solutions.

UNCTAD's (2024) analysis corroborates the challenges identified in MERCOSUR countries, especially regarding the impact of indebtedness on sustainable development. The report highlights that 3.3 billion people live in countries that spend more on interest payments than on education or health. This global reality is reflected in the budgetary pressures faced by MERCOSUR countries, where debt services compete directly with essential investments for development.

6. Policy Recommendations

This research highlights the challenges faced by MERCOSUR countries in terms of fiscal sustainability. Given the outlined scenario, the main policy recommendations aim to encompass structural reforms, institutional strengthening, and regional coordination initiatives aimed not only to ensure public account solvency but also to promote a more robust and shock-resilient macroeconomic environment.

The first fundamental pillar is the implementation of structural reforms to increase budgetary flexibility and improve public spending efficiency. As pointed out by Powell and Valencia (2022), countries such as Brazil face significant budgetary rigidity, with high participation in mandatory spending that limits fiscal adjustment capacity. Reforms that reduce this rigidity, both in terms of current expenditures and constitutional revenue earmarking, are essential to expanding the fiscal space needed to deal with growing spending pressures, especially those associated with population aging.

Simultaneously, reforms that improve public spending quality are equally important. This involves not only reallocating resources from less productive spending to investments with greater impact on growth and welfare but also strengthening public policy selection, monitoring, and evaluation processes. A more efficient public investment regime, based on well-designed projects evaluated and prioritized according to technical criteria, can help mitigate the negative impacts of high debt levels on economic growth.

The second axis of recommendations involves strengthening fiscal institutions. As previously highlighted, robust fiscal frameworks and well-designed fiscal rules are fundamental for expanding control over public finances and increasing fiscal policy credibility. The case of Uruguay, as detailed by Powell and Valencia (2022), offers valuable lessons on how building political

consensus around fiscal responsibility, combined with gradual reforms that strengthen budgetary governance, can contribute to more sustainable debt trajectories.

Improving public debt management is another central element in the institutional field. This involves not only policies aimed at developing domestic debt markets and expanding local currency financing capacity, but also risk management strategies that reduce exposure to vulnerability factors, such as exchange rate volatility and terms of trade shocks. A more resilient debt structure, with longer terms and lower participation in foreign currency commitments, can attenuate the impact of external turbulence on fiscal sustainability.

Finally, the third front of recommendations involves promoting greater regional coordination in fiscal matters. As emphasized by Powell and Valencia (2022), MERCOSUR countries share various vulnerabilities, from sensitivity to commodity price shocks to the challenges associated with post-pandemic fiscal consolidation. Greater harmonization of budgetary practices, combined with sharing successful reform experiences and developing joint financing instruments, can contribute to strengthening the region's fiscal resilience as a whole.

In this sense, initiatives such as creating regional stabilization mechanisms that offer support to countries in moments of fiscal stress or establishing common parameters of fiscal transparency and responsibility can create a mutual protection network against shocks and expand incentives for adopting prudent fiscal policies. Similarly, joint efforts to raise resources in international markets, whether for regional infrastructure projects or financing climate change adaptation policies, can generate scale gains and better financing conditions for all countries.

In summary, building a sustainable fiscal trajectory for MERCOSUR countries in the coming years will require a broad and coordinated set of initiatives. Structural reforms that expand fiscal space and improve public spending quality, combined with strengthening domestic fiscal institutions and greater regional coordination in fiscal policy matters, will be fundamental to reconciling commitment to fiscal responsibility and address the region's pressing economic and social challenges. Only with this comprehensive set of efforts will it be possible to ensure that bloc countries follow a path of greater resilience and fiscal sustainability in the long term.

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