

Asian Development Outlook 2014

Special theme chapter

Fiscal policy for inclusive growth in Asia

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Outline of presentation

1. Emerging case for inclusive fiscal policy
2. Public spending to foster inclusive growth
3. Public revenues to safeguard fiscal sustainability
4. Fiscal planning and innovation for a more inclusive Asia

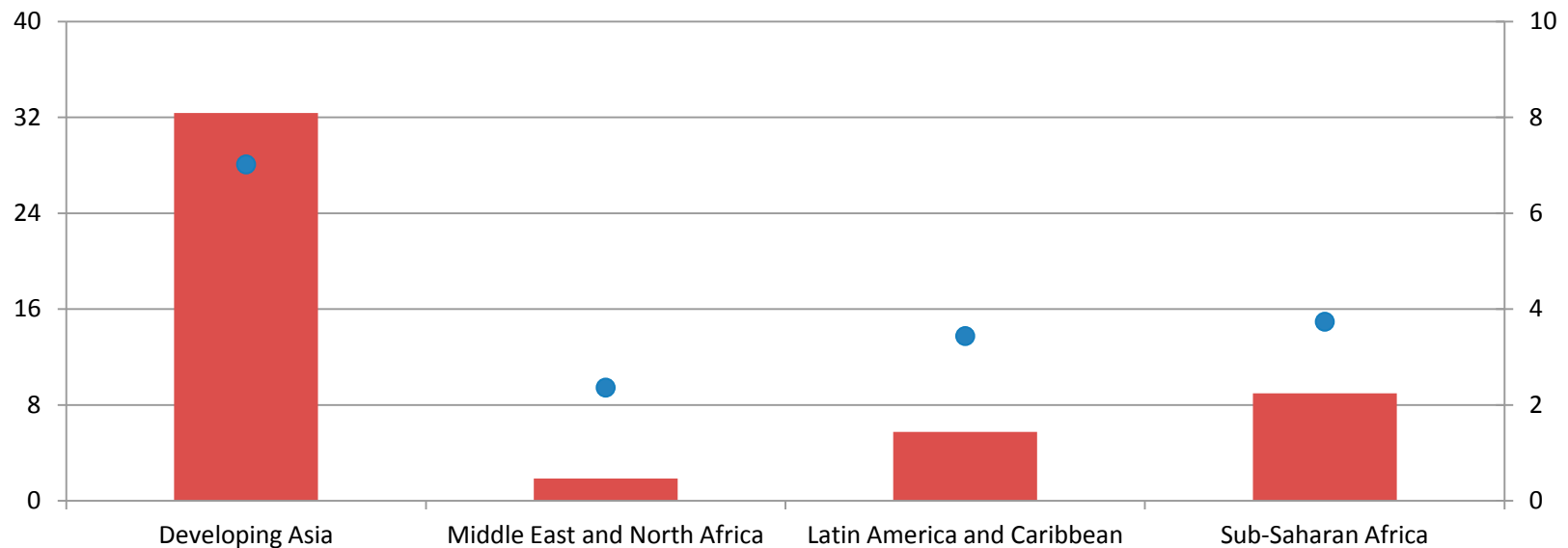
1 Rapid growth has sharply reduced poverty in Asia

GDP growth and poverty reduction, 1990 - 2000

■ Reduction in poverty at \$1.25 a day (2005 PPP\$) ● GDP growth

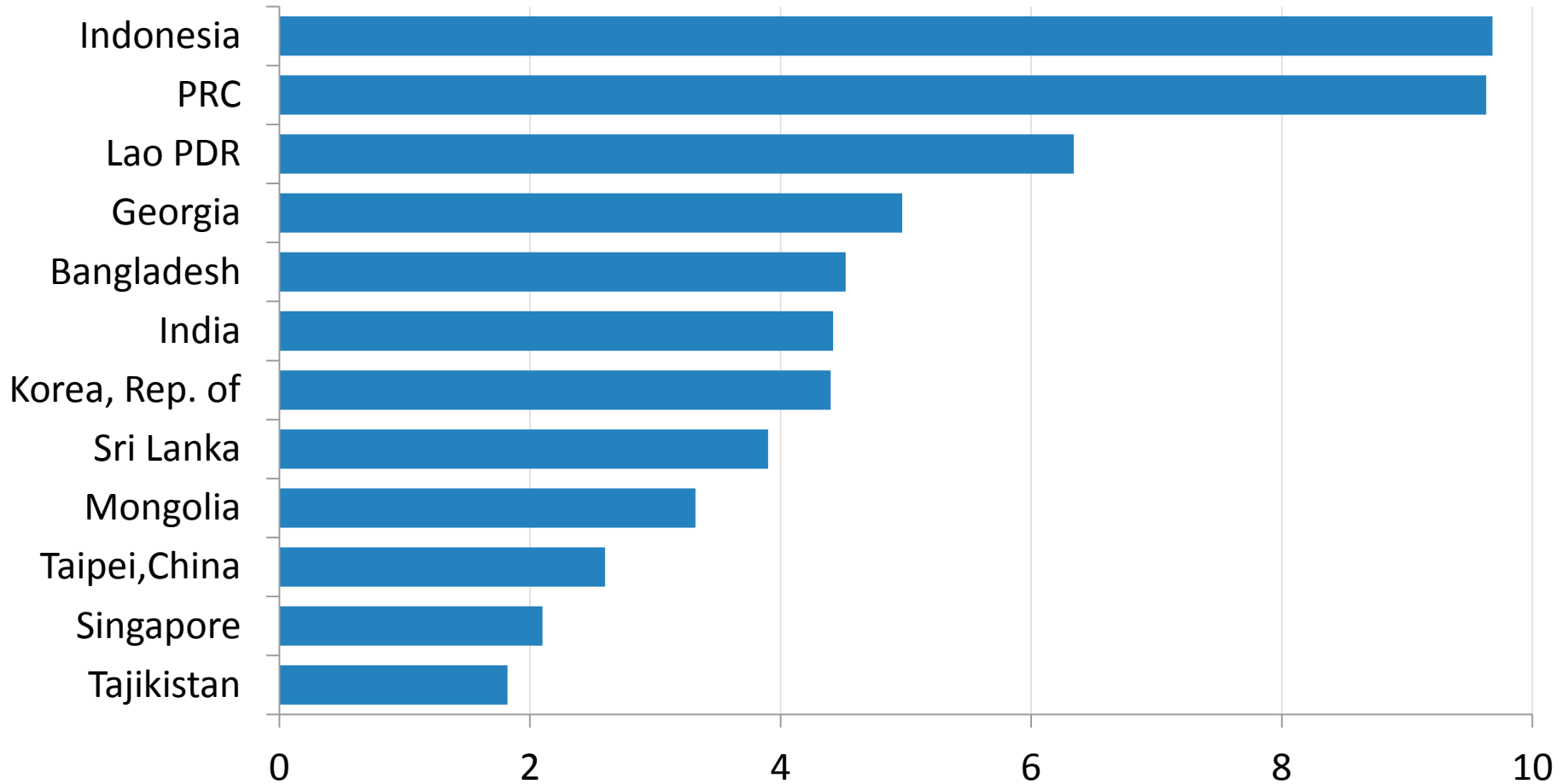
Cumulative reduction in poverty rate, percentage points

Annualized GDP growth rate, %



1 but income gaps are widening

**Increase in Gini coefficient, economies with rising inequality,
1990s - 2000s**



1 Asian governments are beginning to respond via fiscal policy

- International experience shows that public spending can reduce income inequality.
 - For example, education and health
- But in Asia, policymakers traditionally used fiscal policy primarily to support growth rather than to redistribute income
- More recently, growing concern about rising inequality is prompting a major re-think
 - e.g. PRC's Harmonious Society

1 Asian countries now face a tough dilemma

- How can the region use fiscal policy to promote inclusion while maintaining fiscal sustainability?
- Some expansion of public spending will be required, but this may jeopardize fiscal sustainability
 - Korea's scale-back of basic old-age pension
 - Thailand's price subsidy for rice farmers
 - India's rice subsidy
- Therefore, Asian countries must strengthen their revenue base while they calibrate their spending

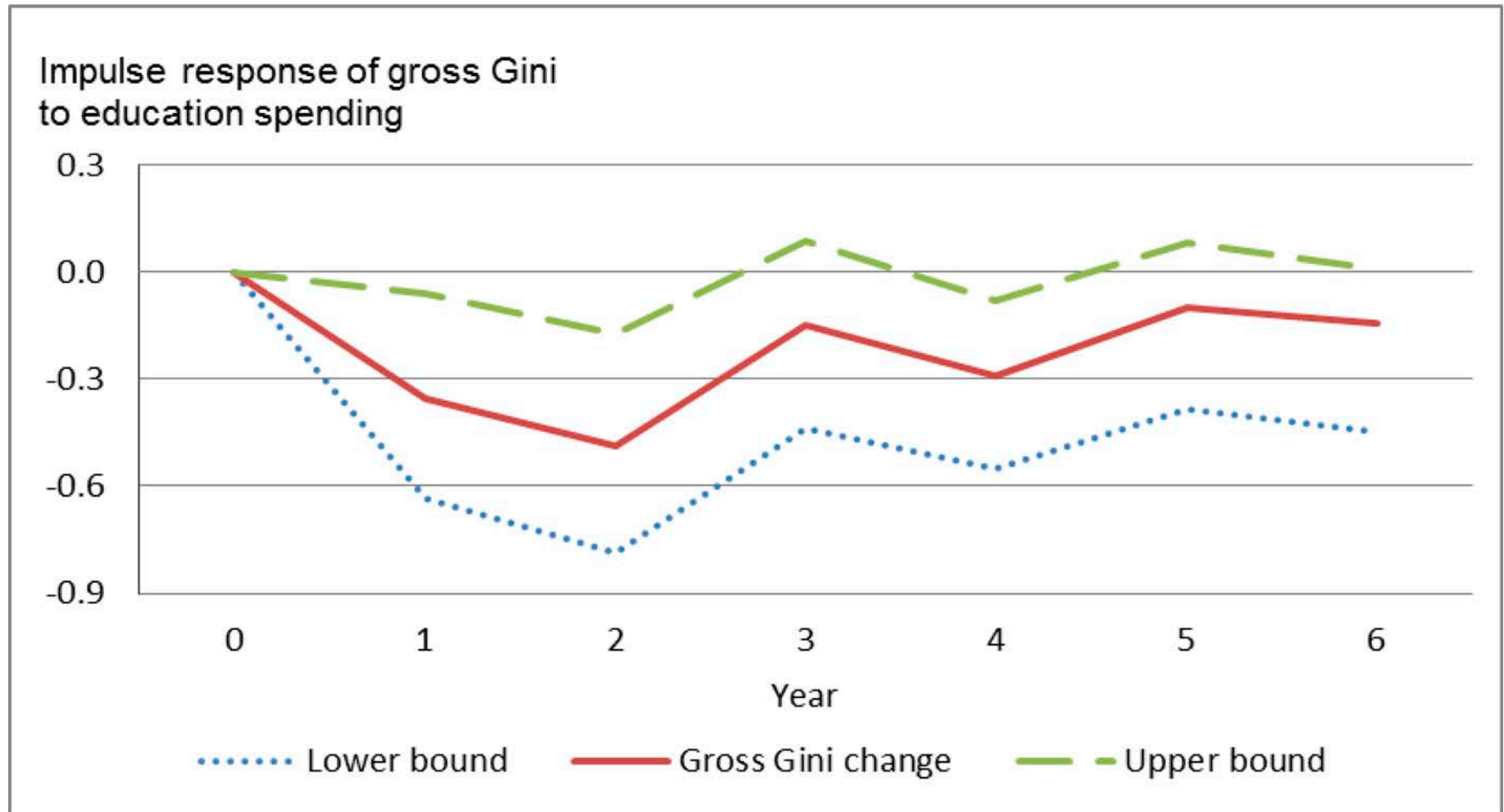
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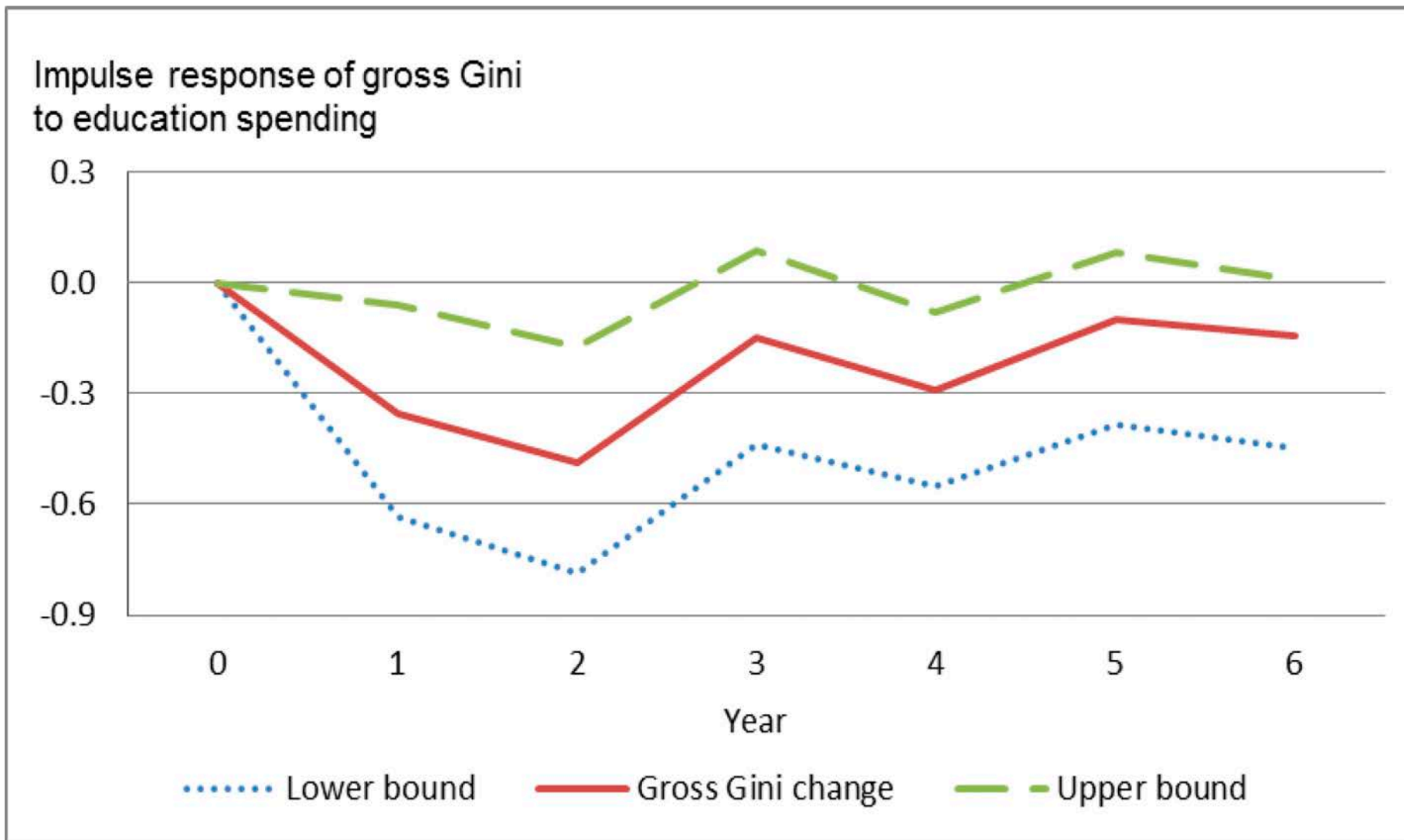
2 Public spending has a bigger effect in reducing inequality

- The evidence from advanced and developing economies alike suggests that government expenditures have somewhat stronger impact on income distribution than revenues
- This general pattern is also true in developing Asia [Claus et al (2014)]
- However, crucially, revenues provide the resources required for inclusive spending

2 Policy simulations re-confirm equity impact of public spending on education...



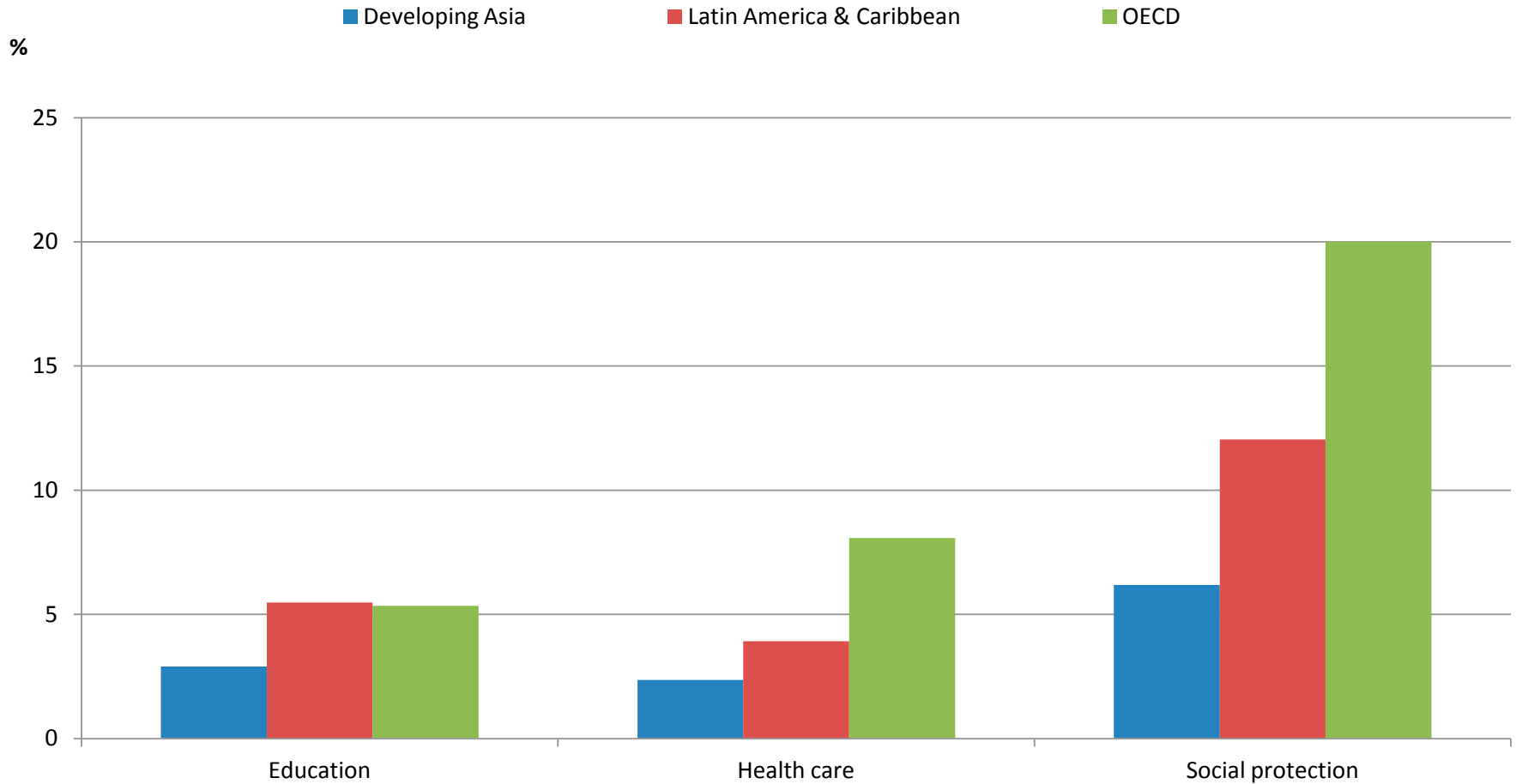
2and likewise for public spending on health



2 Transfers and infrastructure can also contribute

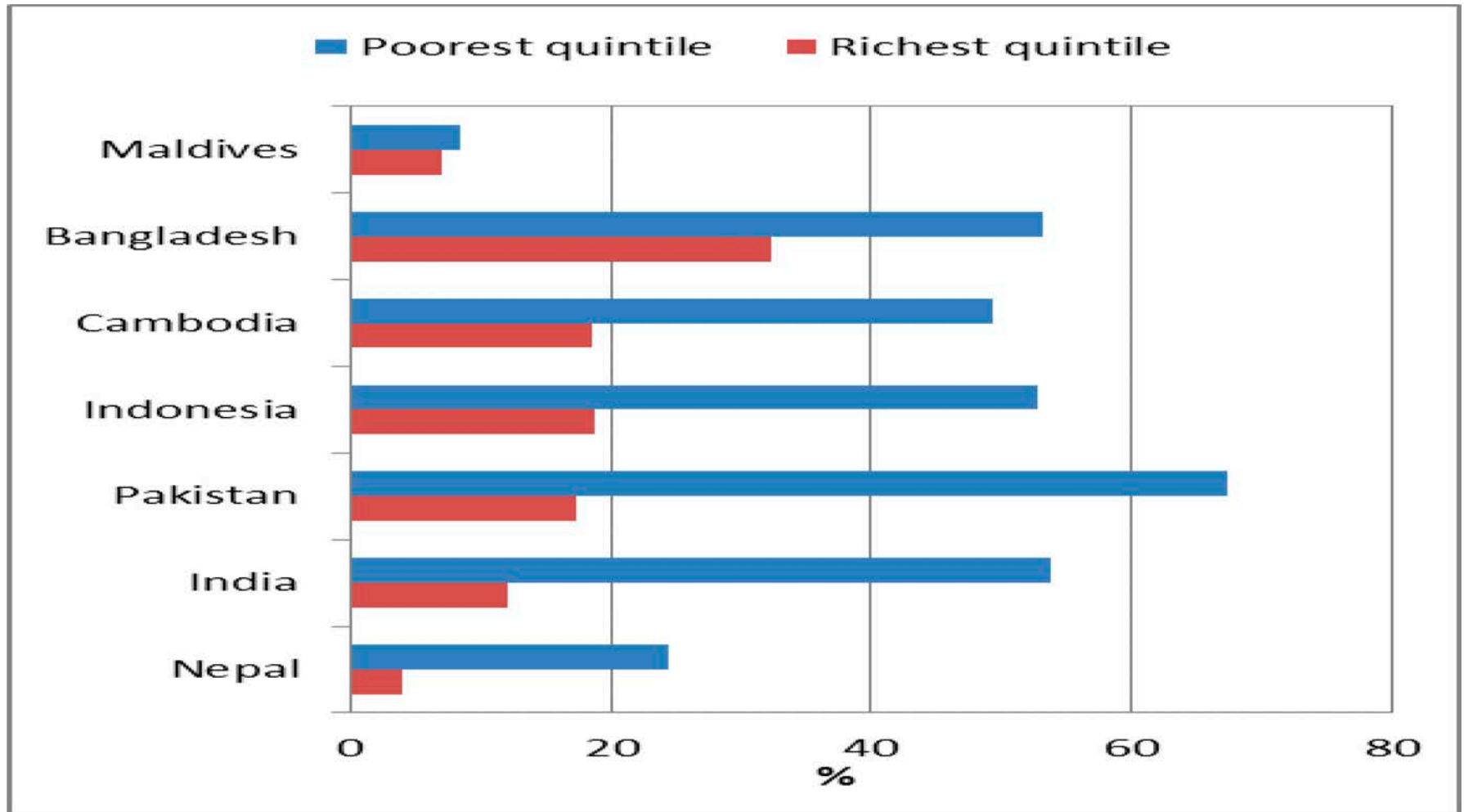
- Targeted subsidies and transfers protect the most vulnerable and deprived segments of society.
- Moreover, replacing distortionary general subsidies with targeted assistance to the poor can contribute to growth
 - ADB analysis of fuel subsidy reform in India, Indonesia and Thailand
- Spending 1 percentage point of GDP more on infrastructure can boost growth by an estimated 1.3 percentage points

2 Asia lags other regions in fiscal spending to promote equity

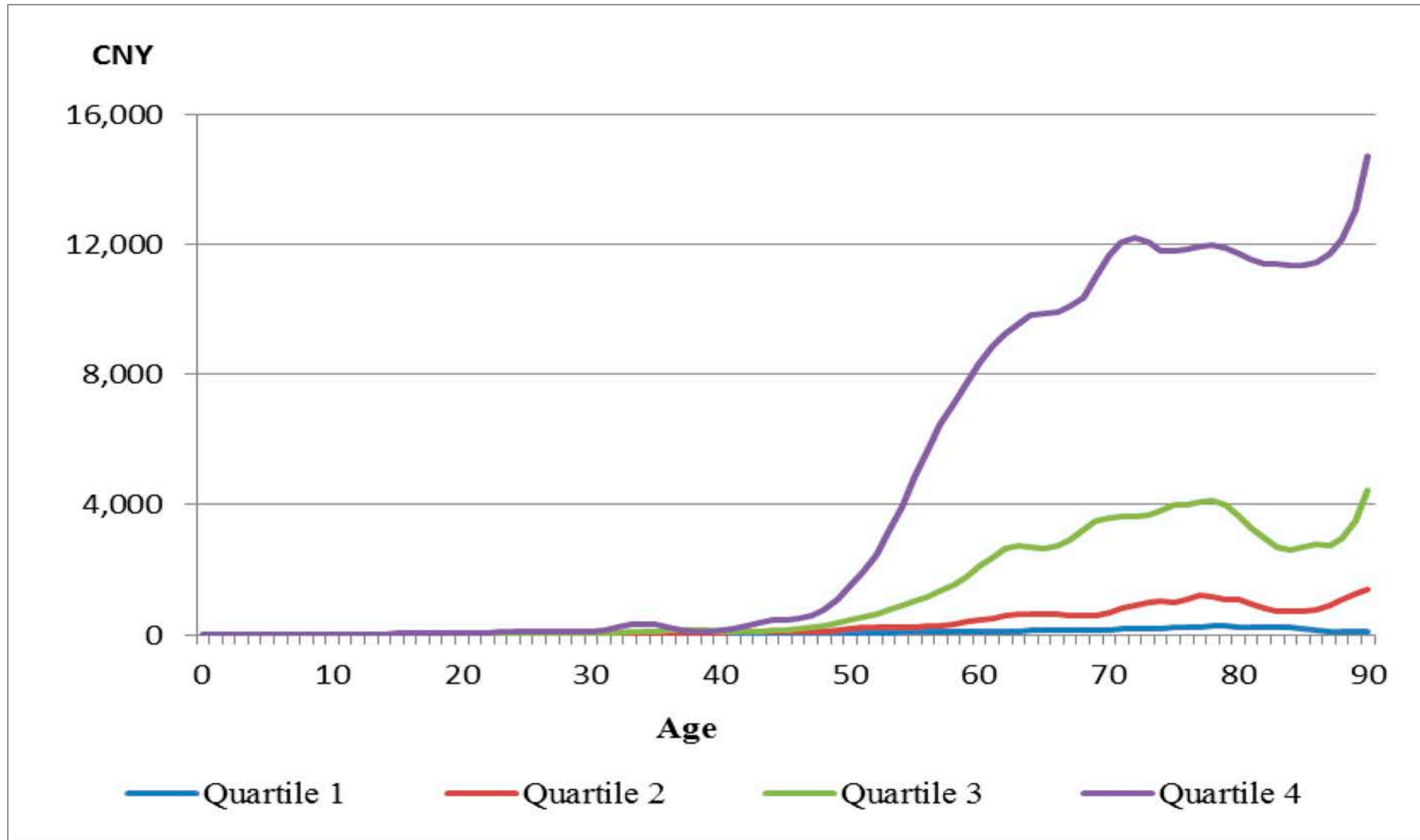


2and the poor lag in access to vital services

Percentage of children not in secondary school



2 Benefit incidence and need for better targeting: some evidence from PRC – public pension spending



2 Besides size of fiscal spending, its composition matters

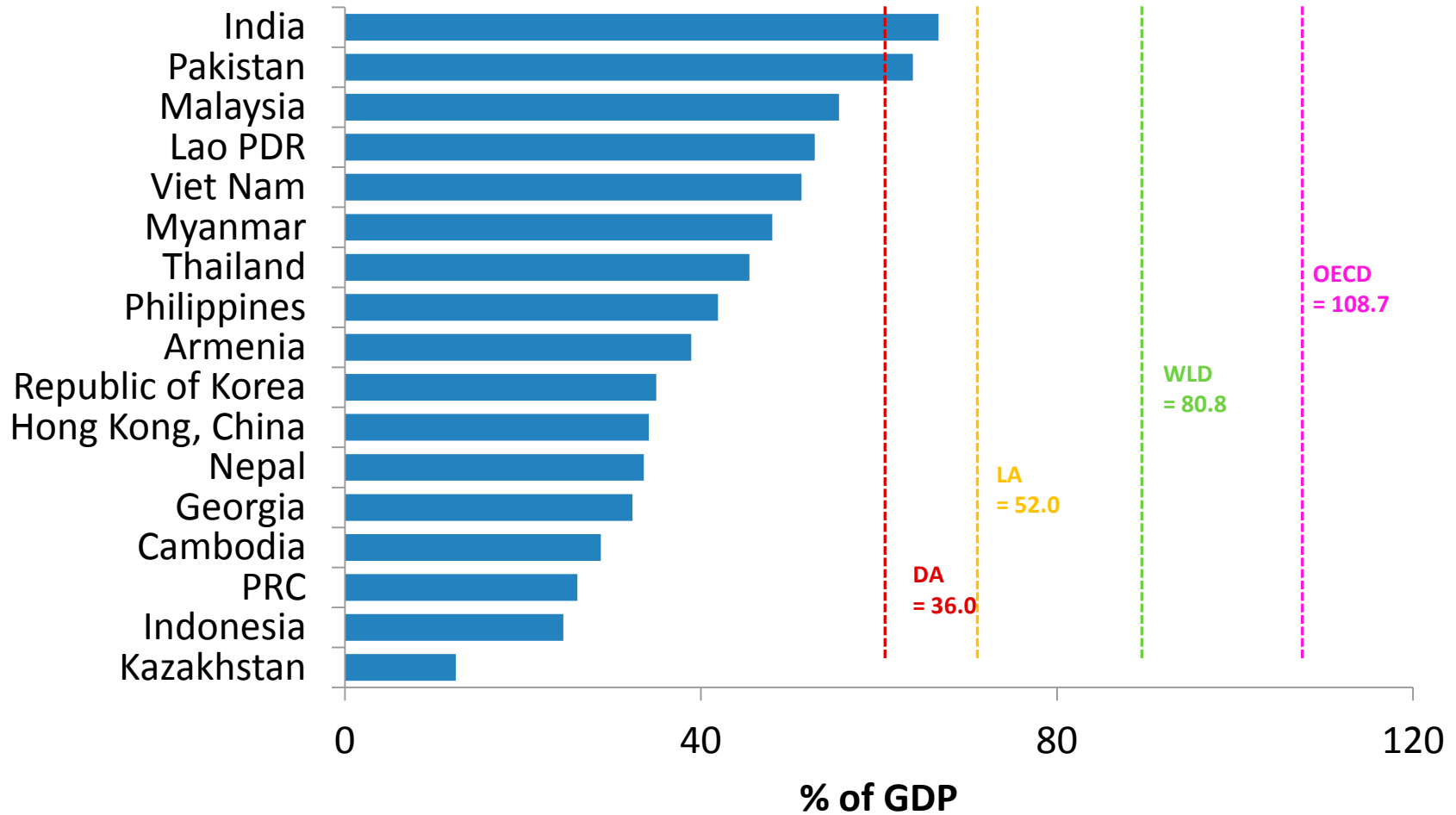
- Education policy can amplify how public spending promotes inclusion by prioritizing basic education or expanding technical and vocational training to give students the practical skills and knowledge they need for work.
- Public health policy can do the same by dedicating the last dollar to a new rural clinic rather than to the latest medical marvel for the urban rich.

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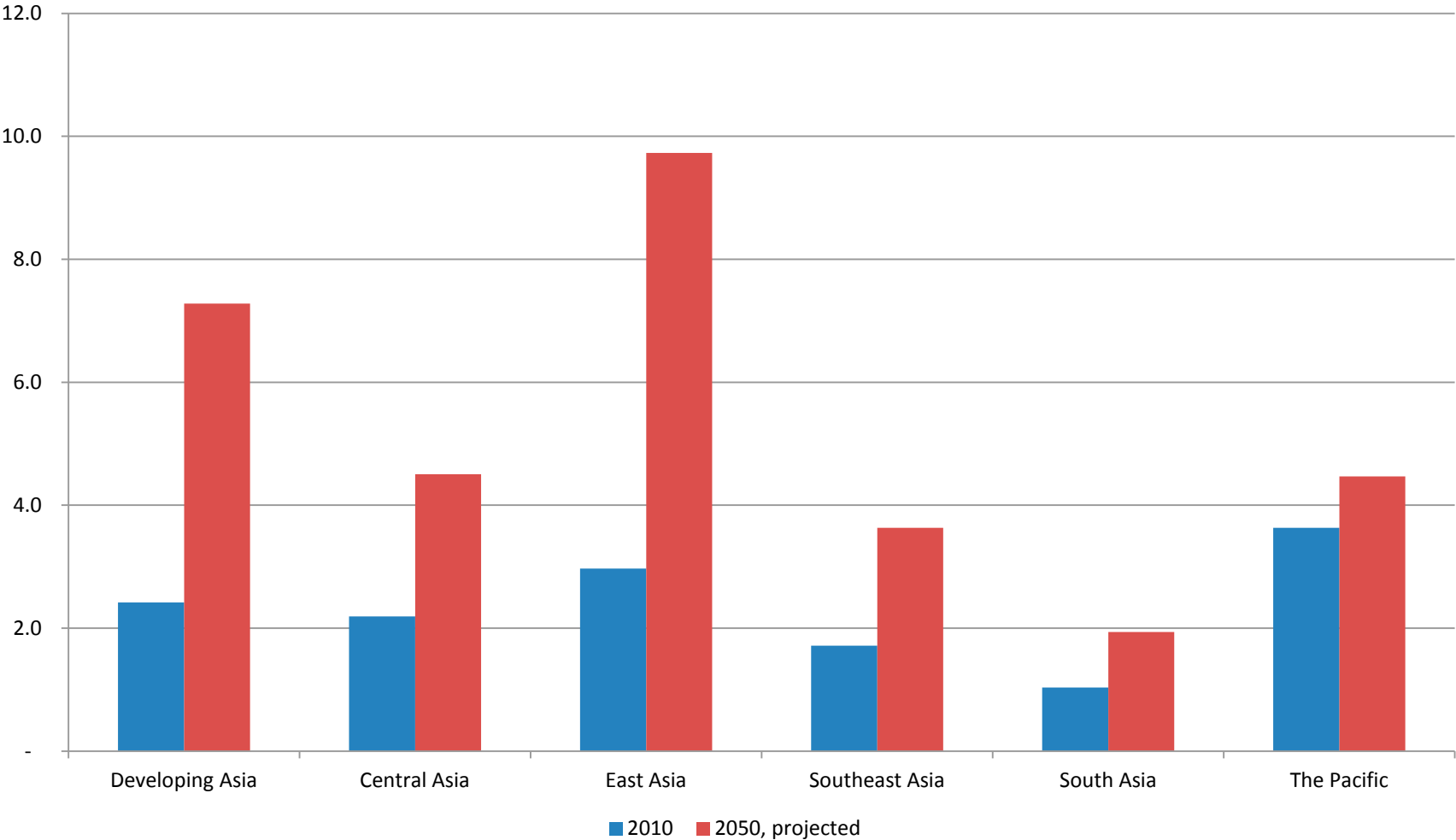
3 Much of Asia currently has fiscal space....

Gross government debt, selected economies, 2012



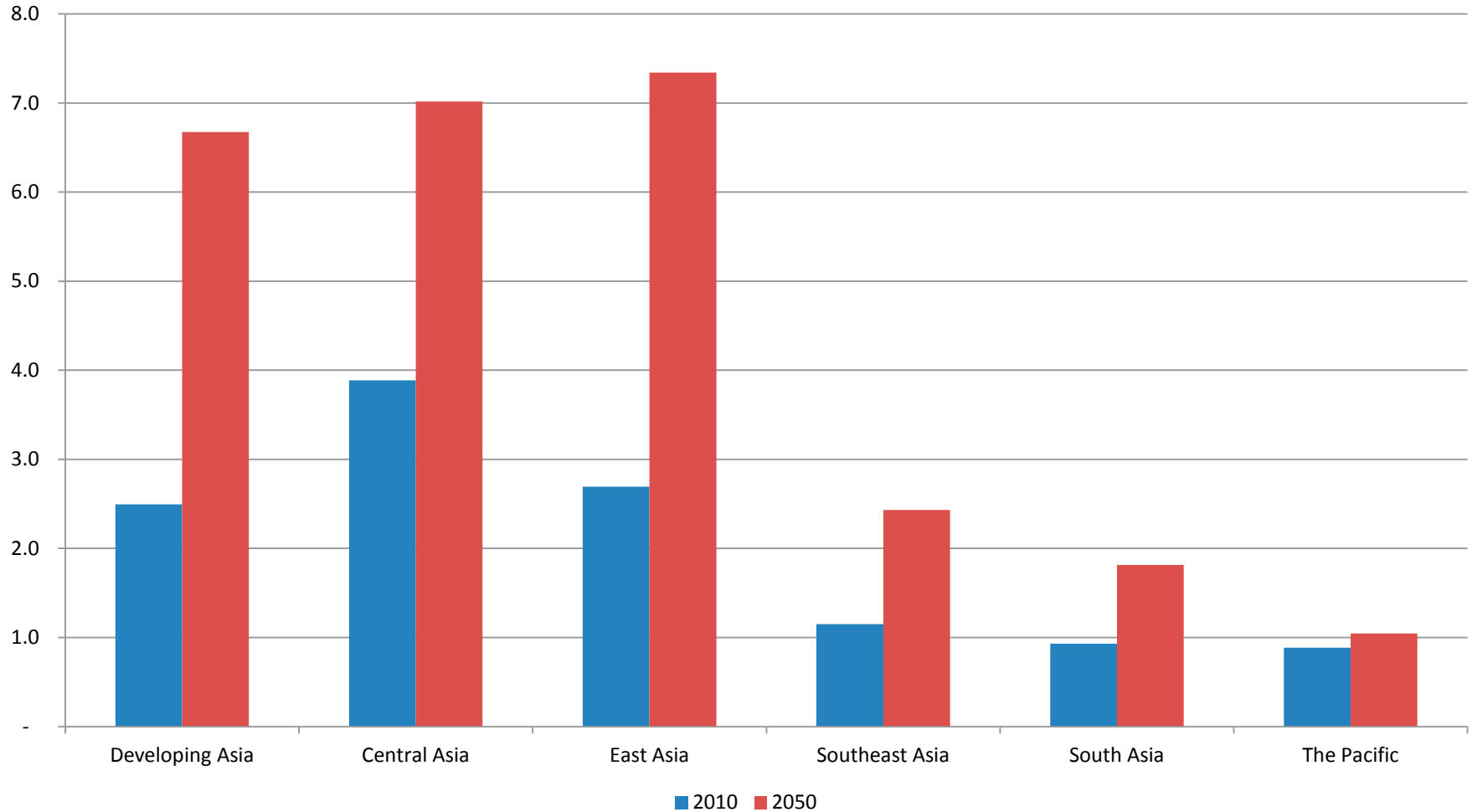
3but faces big future fiscal demands – e.g. health

Share of public spending on health in GDP, 2010 (actual) and 2050 (projected)



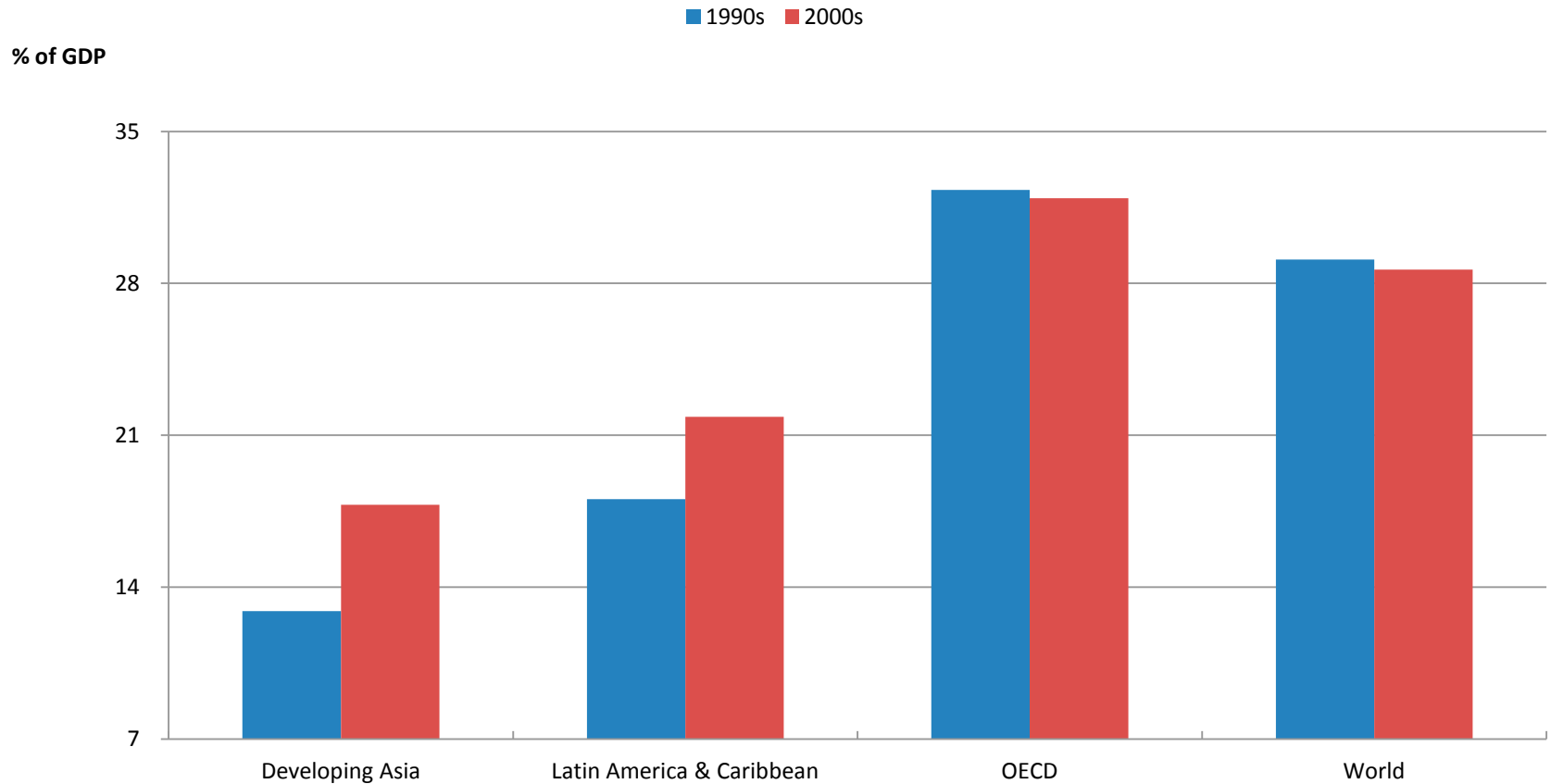
3big future fiscal demands – e.g. social security

Share of public spending on social security and welfare in GDP, 2010 (actual) and 2050 (projected)



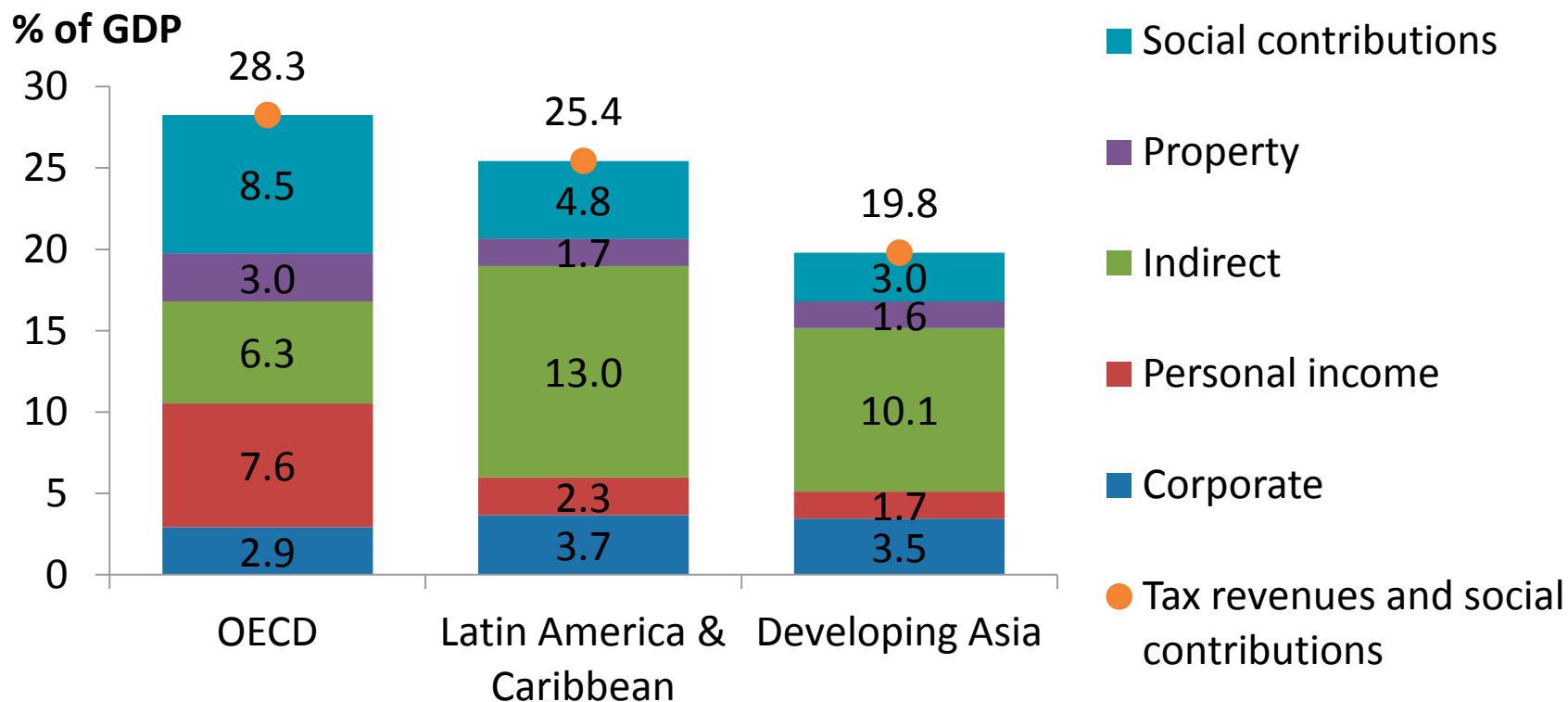
3 Also, Asia has comparatively limited revenue base....

Tax revenues, share of GDP



3.....implying a clear need to improve revenue mobilization across all categories

Composition of tax revenues and social contributions, 2010

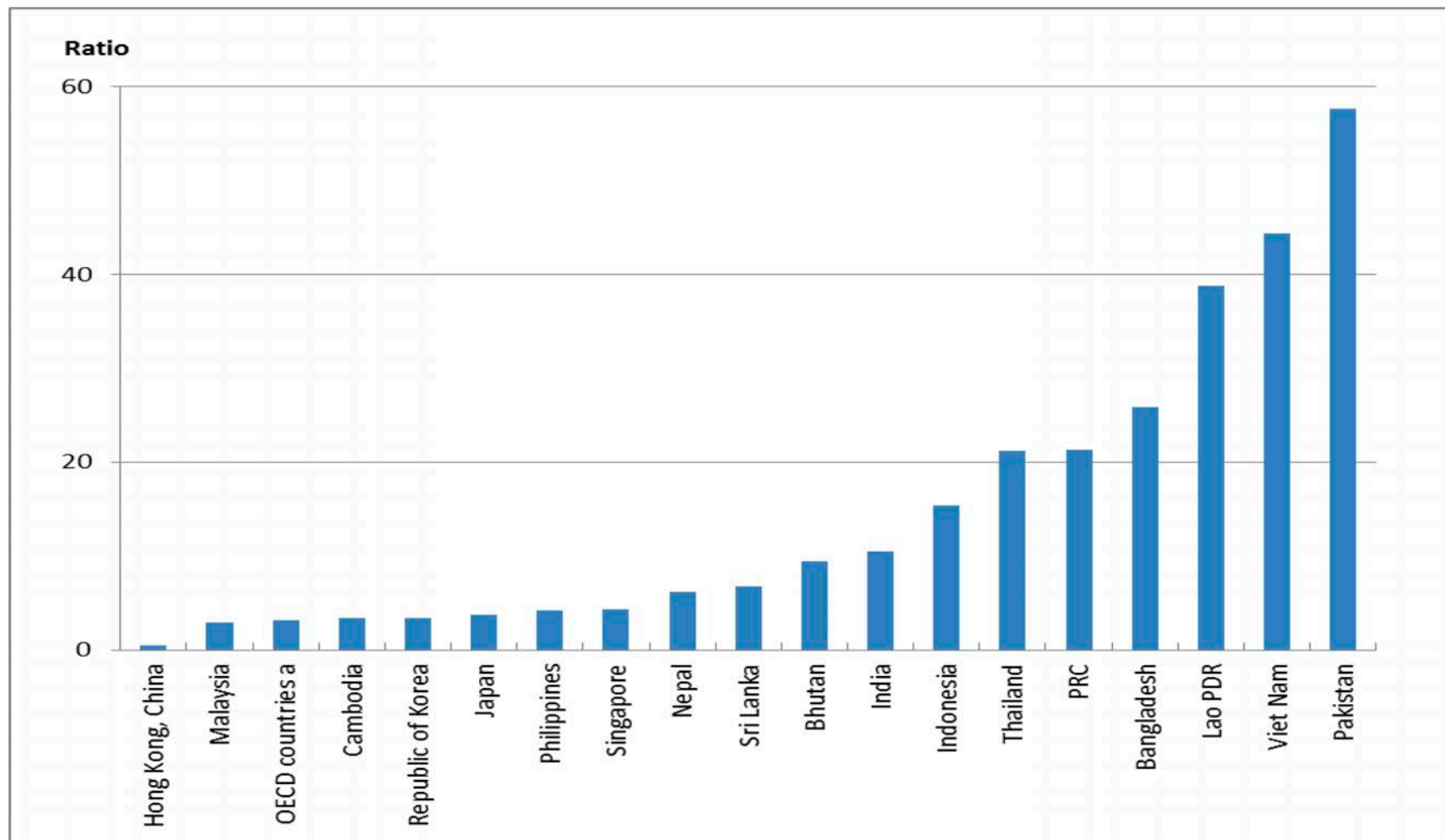


3 A wide range of options should be explored

- Broaden base for personal income tax and VAT
- Increase use of corrective taxes and nontax revenues
- Introduce progressive taxes on property, capital gains, and inheritance
- Improve collection and tax administration through ICT

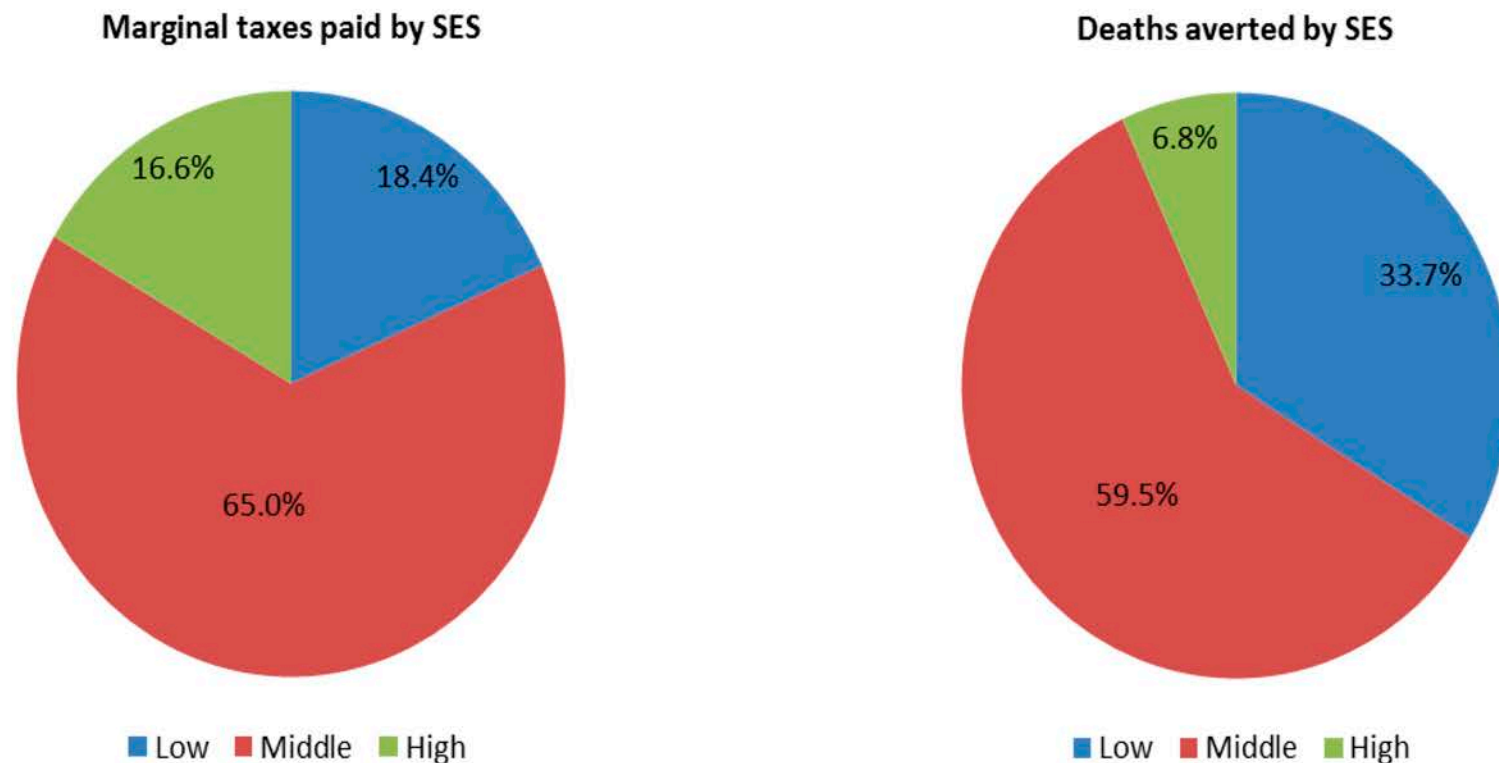
3 Broaden base for personal income tax and VAT

Ratio of top personal income tax threshold income to per capita GNP



3 Corrective taxes and non-tax revenues

Some evidence from an on-going ADB study on tobacco taxes in the Philippines



Note: SES = socioeconomic status group

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4 Medium term fiscal framework for inclusive growth

- MTFFIG should systematize plans for incorporating equity objectives into fiscal policy.
- Such frameworks require careful annual review of inclusive government programs
- They must align concrete medium-term targets with the means
- Importantly, the inclusive elements must be integral to the overall medium-term fiscal framework to preserve fiscal sustainability.
- MTFFIG requires more and better fiscal data, as well as strong political commitment

4 Fiscal innovation for inclusive growth

- Innovative measures can amplify how fiscal policy contributes to inclusive growth.
- For example, forging public–private partnerships in social infrastructure can extend the reach of education and health care services.
- Such measures can provide additional financing for public services and improve their delivery, thus promoting equity.

4 In a manner of conclusion.....

- Fiscal policy can and should play a bigger role in promoting inclusive growth in Asia.
- To put the region on a growth path of broadly shared benefits, Asian governments need to actively target inclusion in their fiscal plans.
- Because achieving inclusive growth is necessarily a long-term challenge, Asian policy makers must plan and act now.