The inclusive growth agenda

-A case for Emerging Mega Economies

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Fiscal Policy, Fiscal space and Inclusive growth

- *Inclusive* growth secures economic growth through investing in the social and human resources that enable such growth to be resilient
- This is a sharp break from the growth mantras of the 1980s and 1990s epitomized in the centrality of policy interventions to scale up those investments that secure the achievement of the Millennium Development Goals (MDGs)
- From a *fiscal* perspective there are two important issues pertinent to this strategic shift
- Many of the objects of public spending for inclusive growth, are financed out of current expenditure **but** *Macroeconomic prudence* requires a zero current deficit except in times of temporary cyclical stress

Fiscal Policy, Fiscal space and Inclusive growth-contd.

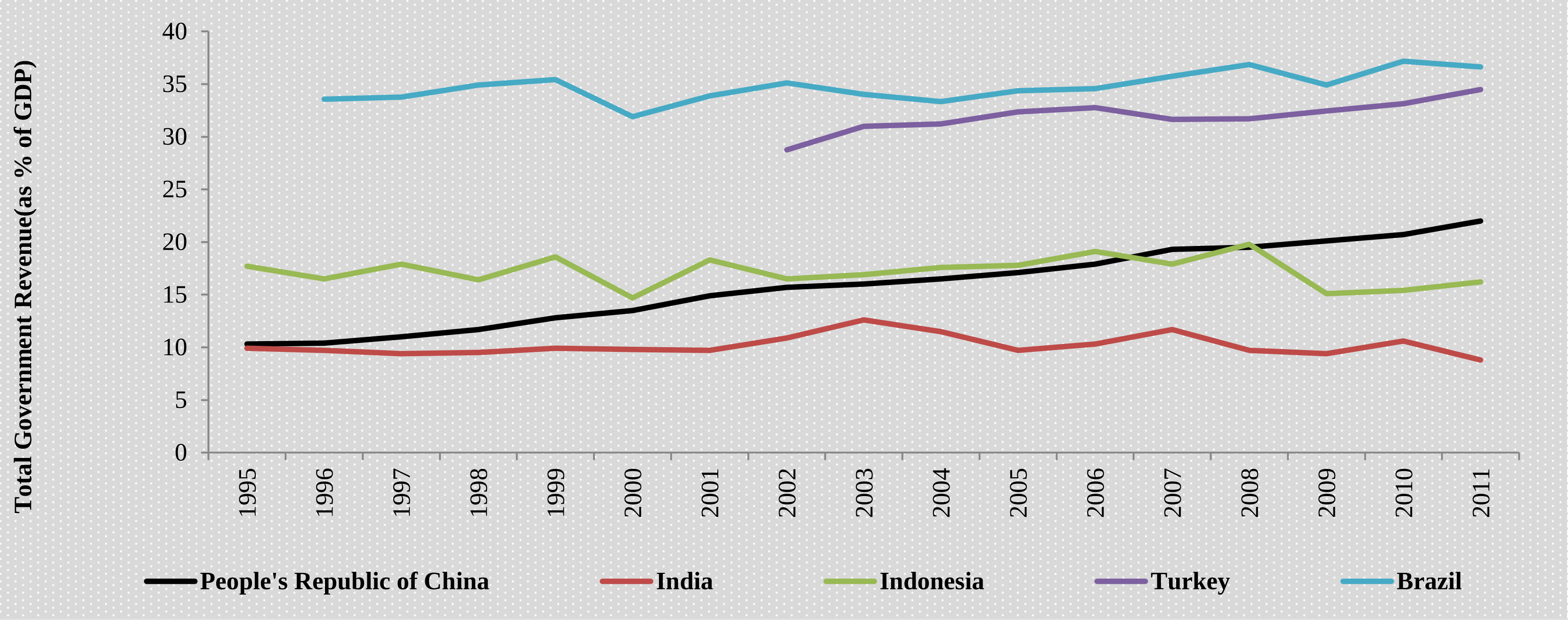
- Emerging Mega Economies (EME) globally face a twin challenge when it comes to use of fiscal policy instruments. The first challenge is long term and that is for fiscal policy to deploy its allocation, distribution and growth enhancement functions to secure inclusive growth consistent with macroeconomic stability objectives. The second is to protect inclusive growth from exogenous shocks by deploying the stabilisation function. The recent global economic crises of 2008 provide us with an opportunity to examine these issues from a policy perspective.

Fiscal Policy, Fiscal space and Inclusive growth-contd.

- We analyse 3 Asian and 2 non-Asian emerging economies namely, India, People's Republic of China (PRC), Indonesia, Brazil and Turkey to
  - identify role of fiscal policy in securing inclusive growth and
  - assess the extent to which stabilisation policies deployed during and after the 2008 crises minimized the impact of the crisis on the inclusive growth objective;
  - we also look at how fiscal policy implementation to secure stabilization was calibrated and whether there were any long term consequences of such calibration.

Overview of Fiscal Trends in EME

- Revenue Trend

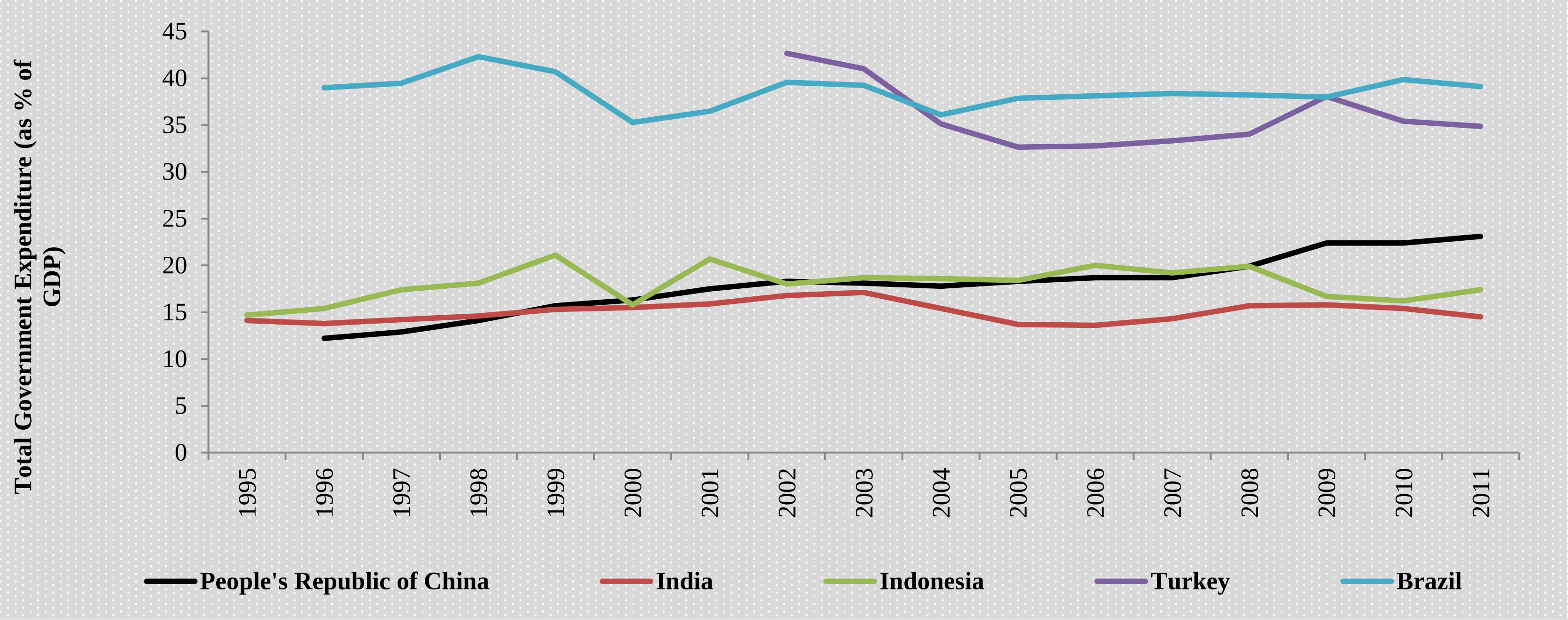


Total Government Revenue in Emerging Mega Economies (% of Gross Domestic Product)

Revenue trends in the EME show no congruence though trends individually are stable.

Overview of Fiscal Trends in EME

- Expenditure Trend



Total Government Expenditure in Emerging Mega Economies (% of Gross Domestic Product)

EME as a group does not share much commonality in expenditure trends.

Public Spending on ‘merit goods’-Education

Table1: Education Expenditure, Public (% of Total Education Expenditure)

Year	People's Republic of China	India	Indonesia	Turkey	Brazil
1995	14.6	-	6.1	-	-
1996	15.2	-	7.5	-	-
1997	-	11.1	7.7	-	-
1998	12.5	13.0	-	-	11.5
1999	11.4	16.3	-	-	9.5
2000	-	16.4	-	-	11.4
2001	-	-	11.2	-	10.6
2002	-	-	14.1	6.5	9.6
2003	-	11.5	16.3	7.1	-
2004	-	10.8	13.8	8.8	11.1
2005	-	10.7	15.3	-	12.0
2006	-	10.4	-	8.6	13.0
2007	-	-	15.0	-	13.2
2008	-	-	13.6	-	14.1
2009	-	10.1	19.3	-	14.8
2010	-	10.5	16.4	-	14.6
2011	-	11.3	15.0	-	-

Source: World Development Indicators

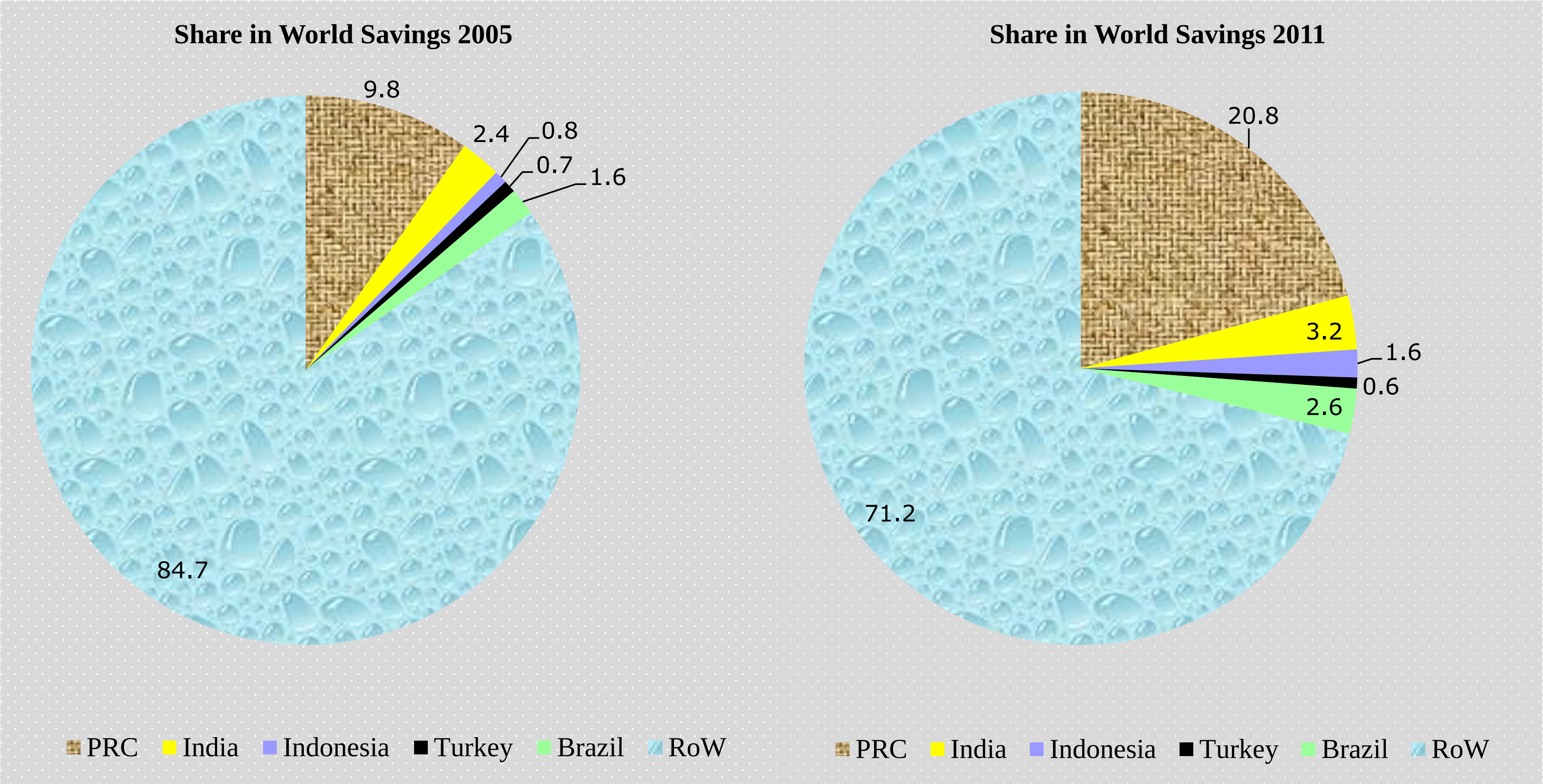
Public Spending on ‘merit goods’-Health

Table2: Health Expenditure, Public (% of Total Health Expenditure)

Year	People's Republic of China	India	Indonesia	Turkey	Brazil
1995	50.5	26.0	35.7	70.3	43.0
1996	46.6	25.7	36.4	69.2	40.5
1997	44.2	25.1	35.0	71.6	43.0
1998	41.8	25.6	34.1	71.9	42.6
1999	40.9	28.0	34.6	61.1	42.7
2000	38.3	26.0	36.1	62.9	40.3
2001	35.6	23.9	43.2	68.1	42.3
2002	35.8	23.2	38.1	70.7	44.6
2003	36.2	22.8	40.1	71.9	44.4
2004	38.0	20.9	39.5	71.2	47.0
2005	38.8	22.1	32.3	67.8	40.1
2006	40.7	23.5	35.2	68.3	41.7
2007	46.9	24.7	39.7	67.8	41.8
2008	49.9	26.3	40.2	73.0	42.8
2009	52.5	27.6	40.0	75.1	43.6
2010	54.3	28.2	36.1	74.8	47.0
2011	55.9	31.0	34.1	74.9	45.7

Source: World Development Indicators

Share of EME in World Savings



Source: World Development Indicators

Descriptive Statistics of Change in Share of EME in World Savings

Year	PRC	India	Indonesia	Turkey	Brazil	RoW
Mean (1995-2011)	10.2	2.1	0.9	0.6	1.7	84.5
Mean(1995-2005)	6.5	1.6	0.7	0.6	1.5	89.2
Mean(2005-2011)	15.4	2.9	1.1	0.7	2.1	77.8
Net Gain/Loss(+/-)						
Mean Savings	**8.9**	**1.3**	**0.4**	**0.1**	**0.6**	**-11.4**

Note: PRC=People's Republic of China; RoW=rest of the world.

Source: Author's calculations based on Data from World Development Indicators.

The impact of countercyclical fiscal policy on growth and inclusion-

Experience of four emerging Developing Asia economies with countercyclical policies following the 2008 crisis-

INDIA

Economic Crisis

National Elections

Fiscal Stimulus of 4% of GDP introduced in 2008

Impact on Sub-National Finances

Combined Fiscal Deficit of 11.4 % of GDP in 2008

Implications for India's debt ratings, but not as immediate as was feared

India's public debt GDP ratio declined from 73% in FY2008 to 66.36% in FY 2011

Why was this the case?

- This was because the tradition of fiscal prudence for both the Centre and the States set in place by the 12th Finance Commission (2004) and reinforced by the 13th Finance Commission (2010) led to increased fiscal discipline at the State level. State deficits thus declined to more manageable levels shortly after the crisis.

The impact of countercyclical fiscal policy on growth and inclusion- INDIA-contd.

- On the other hand, with inflation at around 10 per cent, the nominal value of GDP continued to rise faster than the nominal value of debt.
- Thus, debt sustainability ratios stayed under control.
- In addition the low ratio of external debt to total debt in India and the extremely high proportion of long-term debt in total debt meant that debt management was relatively easy.

The impact of countercyclical fiscal policy on growth and inclusion- INDIA- contd.

- Debt sustainability did not threaten India’s macroeconomic fundamentals; rather the fact that the fiscal stimulus did not result in the expected growth response which led to increasing macroeconomic difficulties for India and the consequent pressure to reduce deficits and therefore fiscal space.

The impact of countercyclical fiscal policy on growth and inclusion-Experience of four emerging Developing Asia economies with countercyclical policies following the 2008 crisis-

CHINA

Economic Crisis

Fiscal Stimulus of 14% of GDP introduced in 2008 and 2009

Fiscal Deficit of 2.3 % of GDP in 2009 > 0.5% of GDP in 2008

Since then

China's growth rate reverted to its 9.6 per cent median growth rate for the period 1995-2001

Thus, fiscal expansion in China was accompanied by the requisite growth payback, thus ensuring fiscal sustainability

The impact of countercyclical fiscal policy on growth and inclusion- CHINA-contd.

- In the case of *China*, the government provided a massive fiscal stimulus equivalent to 14 per cent of GDP for FY 2008 and 2009. This included a fiscal stimulus that is expected to result in a fiscal deficit of 3 per cent of GDP in 2009.

- However, China had plenty of fiscal space to begin with; fiscal deficits had fallen to below 2 per cent of GDP by 2004 and to less than 0.5 per cent of GDP in 2008; the highest fiscal deficit incurred by China was therefore just 2.3 per cent of GDP in 2009. Since that date China's growth rate reverted to its 9.6 per cent median growth rate for the period 1995-2011, thus, fiscal expansion in China was accompanied by the requisite growth payback, thus ensuring fiscal sustainability

The impact of countercyclical fiscal policy on growth and inclusion- CHINA-contd.

- Thus, fiscal expansion in China was accompanied by the requisite growth payback, thus ensuring fiscal sustainability.

The impact of countercyclical fiscal policy on growth and inclusion-Experience of four emerging Developing Asia economies with countercyclical policies following the 2008 crisis-

MALAYSIA

Economic Crisis

Fiscal Deficit of 6.7 % of GDP in 2009 > 4.6% of GDP in 2007

Malaysia's Fiscal Deficit reduced to 4.8 per cent, median rate for the period 1995-2011

To some extent this was necessitated by worsening debt dynamics, both an increase in the debt/GDP ratio to over 50 per cent of GDP in the post crisis period, well above the 1995-2011 median, and an increase in the ratio of relatively more expensive external debt to total debt.

This limited stimulus had little impact on growth, or medium term macro-fiscal policy

The impact of countercyclical fiscal policy on growth and inclusion- MALAYSIA-contd.

- In the case of *Malaysia,* there was an extremely short term fiscal response to the crisis, equivalent to an increase in the fiscal deficit from 4.6 per cent of GDP in 2007 to 6.7 per cent of GDP in 2009. But this was a one year expansion—deficits then reduced down to 4.8 per cent of GDP in 2011 equivalent to the median fiscal deficit of Malaysia for the 1995-2011 period.

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The impact of countercyclical fiscal policy on growth and inclusion- MALAYSIA-contd.

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The impact of countercyclical fiscal policy on growth and inclusion-Experience of four emerging Developing Asia economies with countercyclical policies following the 2008 crisis-

INDONESIA

Economic Crisis of 1998

Fiscal Reforms: Public financial Management & Structural changes in Intergovernmental fiscal relations. Fiscal rules (Fiscal deficit to 3% of GDP; debt/GDP ratio at 60% of GDP))

Indonesia's Fiscal Deficit reduced to 1.1 per cent, median rate for the period 1995-2011, concomitant decline in debt//GDP ratio

2009 fiscal stimulus included tax cuts (2/3rd of stimulus) and expansionary fiscal policy by increase in public spending and subsidies.

Fiscal deficit of 0.7% of GDP in 2010. Fall in both revenue and expenditure as % of GDP since 2008. Thus, fiscal stimulus was not expansionary but involved stimulating the private sector through tax cuts and fall in government/GDP ratio

The impact of countercyclical fiscal policy on growth and inclusion- INDONESIA-contd.

- *Indonesia* went through a fairly long process of fiscal reforms.
- The fiscal deficit-GDP ratio declined continuously.
- The median fiscal deficit in the 1995-2011 period was therefore a very low 1.1 per cent of GDP.
- Indonesia also had in place a fiscal rule which limits the fiscal deficit to 3 per cent of GDP and the ceiling debt-GDP ratio at 60 per cent of GDP

The impact of countercyclical fiscal policy on growth and inclusion- INDONESIA-contd.

- Indonesia’s 2009 fiscal stimulus package involved an expansionary fiscal policy as well as tax cuts.
- Over two thirds of the stimulus came from tax cuts and the rest through increased public spending and subsidies.
- Chiefly due to inability in increasing public spending, the 2010 fiscal deficit was 0.7 per cent of GDP, as against a target of 1.3 per cent.
- As a consequence, both revenues and expenditures fell as a percentage of GDP from 2008.

The impact of countercyclical fiscal policy on growth and inclusion- INDONESIA-contd.

- Thus in Indonesia's case the fiscal stimulus was not expansionary but rather involved stimulating the private sector through tax cuts and a fall in the government(G/GDP) ratio.

The impact of countercyclical fiscal policy on growth and inclusion- BRAZIL.

- Brazil’s response to the crisis was publicly heralded by its government in a sequence of expansionary actions unprecedented in the country’s recent economic history and in sharp contrast to the contractionary policies adopted in 1980s and 90s.

- However, an important segment of this expansionary policy stance was adopted before the crisis. Five structural initiatives (Barbosa 2010) were adopted prior to 2008. These were:

  - The expansion in the mechanisms of social protection
  - The increase in the minimum wage
  - The expansion in public investment
  - The tax cuts associated with Brazil’s new industrial policy; and
  - The restructuring of the government’s career and payroll expenditures

The impact of countercyclical fiscal policy on growth and inclusion- BRAZIL-contd.

- The second feature which marks Brazil from other economies is the active use of monetary policy to a) provide liquidity in both domestic and foreign currency and b) a substantial cut in its base interest rate.
- The fiscal expansion was generous amounting to 6.25% of GDP.(Table C.1) However, like India and China, Brazil expanded public expenditure rather than opting for tax cuts. Infact, an additional income tax of 0.1% of GDP was imposed to partially finance the expenditure expansion. Thus, reduction in tax incidence on the private and household sector amounted to just 0.7% of GDP.

The impact of countercyclical fiscal policy on growth and inclusion- BRAZIL-contd.

Table C.1 Estimates of main counter-cyclical actions by Brazil Government in 2008-09

Recurrent Expenditure (RE)	**(% of GDP)**
Social security	0.45
Social assistance(including Bolsa Familia)	0.08
Increase in net payroll expenditures of federal govt in 2009	0.48
Subsidies in the new housing program in 2009	0.3
Temporary transfers and assitance to regional govt.s in 2009	0.2
Unemployment insurance	0.16
Sub-total	1.67
Capital Expenditure	
Increase in investment in 2009	0.6
Loan to National Development Bank in 2009	3.3
Sub-total	3.9
Revenue	
Tax cuts for firms in 2009 NIP	0.3
Temporary cuts in federal indirect taxes in 2009	0.3
Change in personal income tax system in 2009	0.2
Additional income tax	-0.1
Sub-total	0.7
Grand Total	6.27

Source: Restructured from Barbosa, Nelson (2010): Latin America: Counter-Cyclical Policy in Brazil: 2008-09, Journal of Globalisation and Development, Vol.1, issue1.

The impact of countercyclical fiscal policy on growth and inclusion- TURKEY

- After long history of macroeconomic instability, Turkey, after the 2001 crisis, undertook important reforms which have been largely successful. These include monetary policy governed by an independent Central Bank with an inflation targeting framework, a restrained fiscal policy resulting in a typically stable and occasionally declining public debt/GDP ratio, and well regulated and supervised banks with strong balance sheets.
- However, Turkey continued to face a widening external account deficit and despite reasonable growth rates and macro stability, a falling domestic savings-GDP ratio. This meant that while Turkey had strong macroeconomic foundations, its structural problems limited the scope for expansionary countercyclical fiscal policies. (Rodrik 2012)

The impact of countercyclical fiscal policy on growth and inclusion- TURKEY-contd.

- Remarkably, Turkey’s revenue-GDP ratio in fact rose through the crisis period. This was not because Turkey increased tax rates across the board (except raising tobacco and fuel taxes in 2009). The rise in tax revenue was generated principally through increase in tax base using one-off schemes like voluntary disclosure, tax amnesty and asset repatriation programmes. The focus of Turkey’s fiscal stimulus was, therefore, on expenditure measures (Table C.2)
- The G/GDP expanded principally through a sustained increase in government investment expenditure though government consumption expenditure also rose up by 0.5% of GDP. There were also significant increase in transfers to households and sub-national governments.

The impact of countercyclical fiscal policy on growth and inclusion- TURKEY-contd.

Table C.2 Fiscal Stimulus in Turkey

	2008	2009	2010
Expenditure Measures (As % of GDP)	0.8	1.8	2.0
Govt investment	0.5	0.7	0.6
Govt consumption	0.1	0.3	0.5
Contributions to social security funds	0.0	0.5	0.5
Total Transfers of which	0.1	0.3	0.4
Transfers to households	0.0	0.0	0.0
Transfers to business	0.0	0.1	0.0
Transfers to sub-national governments	0.1	0.3	0.3
others	0.1	0.1	0.0

Source: Author's calculations based on data sourced from Rawdanowicz, Lukasz(2010): The 2008-09 Crisis in Turkey: Performance, Policy Responses and Challenges for Sustaining the Recovery, OECD Economics Department Working Papers, No.819, OECD Publishing.

Concluding Remarks

- The EME show that countercyclical fiscal policies deployed, have been tailored to individual circumstances, and have been mindful of prudential limitations thus alleviating the fear that persistence with such policies would jeopardize fiscal prudence.

- Thus, these economies followed very different strategies with very different outcomes after the 2008 financial crisis. The chief impact on inclusive growth seems to have been driven by the impact of the fiscal stimulus on growth.

- All EME tried to maintain fiscally prudent policies in administering the fiscal stimulus, even India. It was the failure of the fiscal stimulus to maintain growth that resulted in concomitant pressures on economic activity chiefly through inflation, high nominal interest rates, and rising current account deficits in that country.

Concluding Remarks

- It is clear from our analysis of macro fiscal and sectoral trends on ‘merit’ goods like health and education that while EME display considerable convergence on growth, they do not show any convergence on revenue policy, the size of government in GDP and policies on public spending on merit goods like health and education.
- There is then considerable scope in all the EME other than Brazil to increase public spending on merit goods like health and education before resorting to redistributive fiscal policies.
- To be sure, since expenditure on merit goods involve substantial increase in current expenditure as opposed to capital expenditure, the EME will need to raise their tax effort to finance such an increase in merit goods provisioning.

Concluding Remarks

- As far as inclusion goes, this paper does not find any dramatic, first-order link between performance in individual measures of inclusion and the conduct of fiscal policy.

- In the EME, there is an apparent case for redistributive measures to address the increase in top–bottom inequity in consumption, and this may be feasible consistent with fiscal prudence for the PRC alone.

- In all other EME, inclusion is best served by using fiscal policy as an instrument to maximize public spending on merit goods and to secure a growth maximizing macro-fiscal environment.

THANK YOU