



Forum on

Inclusive Growth and Poverty Reduction in the New Asia and Pacific

8-9 October 2007 • ADB, Manila, Philippines



Session 7B: Inclusive Social Service and Non-Income MDGs

Growth and Public Finance for MDGs in Growing Economies

By: M. Govinda Rao, National Institute of Public Finance and Policy

1 INTRODUCTION:

1. Acceleration in economic growth in some of the highly populated emerging economies has brightened the prospects of improvement in the human development of the large number of poor people in these countries. Indeed, of the ten large and fastest growing economies in the World, seven are in the Asia-Pacific Region. China and India –the two largest and fastest growing economies account for 37 per cent of the World’s population. They also account for more than a half of the World’s poor living on less than one dollar a day. The health status of the population in some of the emerging market economies of particularly in South Asian countries is low and more rapid growth presents better prospects of progress in human development for the poor in these countries.

2. Improvement in human development contributes to human capabilities and enables greater freedoms – freedom from poverty and hunger, freedom to participate meaningfully in economic activities and freedom to choose avocations. Millennium Development Goals (MDGs) represent the most comprehensive set of goals to build capabilities and enable freedoms, particularly to the poor and disadvantaged sections of society. They represent essential components of human development in its different dimensions including income poverty, education, healthcare, water supply and sanitation and environmentally sustainable development.

2 MILLENNIUM DEVELOPMENT GOALS:

3. The Millennium declaration in 2000 set eight quantifiable MDGs to be achieved by 2015. Briefly, these include: (i) eradication of extreme hunger and poverty and halving the population living on less than \$ 1 a day and halve malnutrition; (ii) achieve universal primary education; (iii) promote gender equality and eliminate gender disparity in schooling; (iv) reduce child mortality by two-thirds; (v) reduce maternal mortality by three-quarters; (vi) Reversing the trend in HIV/AIDS and other diseases such as malaria and tuberculosis; (vii) ensure environmentally sustainable development and reduce by half the proportion of people without access to safe drinking water and sanitation and (viii) develop global partnership in development and reform trade and aid to provide special treatment and to ensure greater opportunities for the poorest countries.

4. Despite high growth rates, there is considerable distance to be traversed in achieving the MDGs in many of the emerging economies in the Asia Pacific region. Even in China, despite a strong record of improving human development indicators in a variety of areas, the possibility of reducing the incidence of child mortality by two-thirds is doubtful. Although it has achieved the target of halving the income poverty from 1990 levels, incidence of child mortality is high (730000 children every year) and the rate of reduction declined from 2.3 per cent in 1980s to 1.9 per cent during 1990-2003. In India, record in achieving the MDGs is mixed and significant additional

efforts will be needed in many of the education and health indicators and in reducing child mortality, it is widely off track. In other words, even as the emerging economies have moved into higher growth trajectory, they have not been able to make sufficient efforts at improving human development indicators in line with MDG targets.

3 COMMITMENT TO HUMAN DEVELOPMENT AND COMPETING CLAIMS ON PUBLIC FINANCES:

5. Additional commitment to improve human development in emerging economies will have to be demonstrated in terms of both higher public spending and improved efficiency in service delivery. Public spending on education and healthcare is particularly low in South Asian countries. Public expenditure on education relative to GDP in 2000-02 was less about 4 per cent in India, 2.4 per cent in Bangladesh and less than 2 per cent in Pakistan. Similarly, public expenditure on health relative to GDP was just about 1.2 per cent in India 1.1 percent in Pakistan 0.8 per cent in Bangladesh 2.3 per cent in China, 2.6 per cent in Pakistan, 1.5 per cent in Bangladesh. Inadequate public spending on education and health has driven the poor to the mercy of the private sector for these essential services. In India, for example, household spending on health is four times the public expenditures in India; it is three times in Bangladesh and over two times in Pakistan.

6. Achieving MDGs in emerging economies would require them to commit significant additional budgetary resources for education, healthcare, water supply and sanitation and for anti-poverty interventions. The focus of spending will have to be not so much to provide consumption entitlements, but more importantly, to build capabilities of the poor and disadvantaged sections. At the same time, most growing economies are confronted with the problem of meeting competing demands on their budgetary resources. In a globalizing environment, providing enabling environment for the market requires them to significantly upgrade the infrastructure which would call for significant additional budgetary allocations. This has to be done in the wake of significant revenue loss from reducing tariffs. Open economies and increased capital flows reduce the degree of flexibility in calibrating monetary and fiscal policies. Thus, the emerging economies even as they register faster growth have to operate under limited degrees of freedom in their public finances.

7. Open economy not only requires increased allocations to infrastructure presents significant constraints on the ability of the governments to raise revenues and to borrow. Open capita mobility and stable exchange rate limits the ability of these governments to calibrate independent monetary policy. The impact of fiscal imbalances with macroeconomic imbalances and balance of payments equilibrium limits the ability of the governments to borrow in an open economy environment. Some emerging economies like India have undertaken fiscal restructuring programs and have legislated ceilings on borrowings. Keeping the economy open also entails keeping the tax rates low to minimize disincentives of the tax system on work, savings and investment. The WTO requirement to reduce tariffs in most low and middle income economies significantly reduces government revenues which add pressure on the ability to make large volume of resources for human development. The usual advice offered to developing countries to make up the loss of revenues from customs is to levy the value added tax (VAT). However, when the economies are not well organised and tax administration is not modern introduction of VAT could hinder the development of organised markets. In any case, the experience shows that VAT can not entirely offset the revenue loss from customs in most economies.

8. Additional fiscal space for human development will require the governments to undertake a series of policy and institutional reforms. These are summarised in the following:

- (i) Redefine the role of the state: Most of the middle income and growing economies still have vestiges of the planning era including significant presence of state owned enterprises and large volume of subsidies arising from controls on prices and output. These need to be reformed to limit the role of the governments to public goods provision and clear cases of market failure. It is important to involve the private sector in many of the activities traditionally undertaken by the government. Public private participation in infrastructure projects would have to be promoted.
- (ii) Promote diplomacy and avoid conflicts: In many of the economies, conflict situations have warranted substantial resources to be spent on defense. Diplomatic initiatives could release these resources for development. Reduction in defense budgets in developed countries could enhance resources available for international initiatives in human development, particularly in least developed countries.
- (iii) Reforming the tax system: This is extremely important in emerging countries to minimize distortions and to raise revenues. High growth of GDP can bring in more than proportionate increase in tax revenues if the tax system in these economies is buoyant. The best practice approach to tax reform is to broaden the base, reduce the rates, reduce rate differences and have a simple and transparent tax system. The emphasis of the concept of equity in tax policy has shifted from 'reducing the incomes of the rich' to 'increasing the incomes of the poor' which implies that the burden of redistribution has substantially shifted from the tax to the expenditure side of the budget. Tax administration reform is a critical element of tax reform. In particular, keeping the tax system simple and building a scientific information system along with legal reforms to ensure expeditious decisions could help to improve the tax compliance significantly. In India, since 2002-03, setting up the Tax Information Network (TIN) has helped to improve tax compliance and increased the revenue-GDP ratio by over 3.5 percentage points.
- (iv) Raising revenues through user charges on quasi-public services would be extremely important. In some cases, it may be important to ensure that poor have access to these services through appropriate arrangements for loan finance.
- (v) Significant proportion of financing of both physical and social infrastructure will have to come from bilateral and multilateral development institutions. However, this should not create a dependency syndrome and the assistance from these institutions should not be a means of creating employment opportunities to the consultants from advanced economies. The focus should be on building capacity in these countries.
- (vi) The growing economies should adopt strategic approach for human development in the lagging regions where the poor and disadvantaged sections are concentrated. The strategy should not only in terms of targeting resources for human development in these regions but also to enhance efficiency in service delivery. The right type of decentralization could enhance both efficiency and accountability in service delivery. Stakeholder participation in service delivery could help to mobilize resources and enhance social accountability. This could also impart efficiency in implementation.