DEVELOPING ASIA’S FISCAL LANDSCAPE AND CHALLENGES

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ABSTRACT

What are the salient features of developing Asia’s tax revenues and public expenditures? How do these compare with other economies and how have they been affected by the coronavirus disease (COVID-19) pandemic? To analyze these issues we assemble data across economies drawing on a range of sources to maximize temporal and coverage of economies. We find that while tax revenues in developing Asia steadily rose in the 2 decades before COVID-19, they continued to lag behind high-income economies and some developing peers. The region relies on indirect taxes, particularly consumption taxes, creating a relatively efficient but less progressive tax structure. Alongside these lower tax revenues, government expenditures on education and health were comparatively modest. Substantial fiscal policy stimulus in response to COVID-19 comprised both tax and expenditure measures which, combined with the impact of the downturn on revenues, has severely weakened public finances in many developing Asian economies.

Keywords: tax revenue, government expenditure, pandemic crisis

JEL codes: E62, H12, H20, H30
I. INTRODUCTION

A fundamental role of government in promoting sustainable and inclusive development is providing essential public goods and services, and direct support to households to tackle poverty and inequality. Governments can help ensure the provision of public goods and services that would be under-provided by the private sector. Particularly in developing economies, governments also provide goods and services that directly augment private goods as well as market-supporting public goods that enable the poor to participate in the economy (Besley and Ghatak 2006). Social returns on spending in areas that generate positive externalities, notably health and education, and physical infrastructure such as water and sanitation can exceed private returns, providing a further strong rationale for government provision. Moreover, where credit constraints are often large because of underdeveloped financial markets, poor households are highly dependent on government provision.

Meeting public expenditure needs require governments to have access to a strong, reliable, and adequate stream of revenues such as tax revenues. Among available revenue sources, official development assistance (ODA) is inherently limited and depends on economic circumstances and policy priorities of donor economies. The ability of governments to borrow varies according to income levels, with the governments of the poorest economies the least able to borrow. Large-scale borrowing is typically confined to physical infrastructure, for which collateral is more readily available, and less available for funding general spending gaps or recurrent expenditure. Governments can face difficulties borrowing precisely when expenditure shortfalls and borrowing requirements are greatest, e.g., during an economic crisis. Even in normal times, developing economies pay a risk premium, and may be forced to borrow short term in foreign currencies. Finally, revenues from state-owned enterprises can be unreliable. Indeed, inefficient state-owned enterprises often impose a burden on public finances.

Ensuring adequate government expenditures and tax revenues is a critical element of domestic resource mobilization (DRM) and central to domestic and international development efforts (Addison, Niño-Zarazúa, and Pirrttilä 2018). Since the mid-1990s, successive initiatives for heavily indebted poor economies have aimed to ease debt burdens and create fiscal space for government spending. More recently, in 2015, the Third United Nations Conference on Financing for Development focused on mobilizing financial resources to meet development goals, concluding with the Addis Ababa Action Agenda on a sustainable financing strategy. The Agenda emphasizes “public policies and the mobilization and effective use of domestic resources... [recognizing] that domestic resources are first and foremost generated by economic growth, supported by an enabling environment at all levels” (United Nations 2015). DRM can be conceptualized as a virtuous cycle of domestic revenue generation, the efficient and effective allocation of domestic resources, and the contribution this makes towards sustainable economic growth and development (Figure 1). Within this framework tax revenue represents a vital component of domestic resources. The achievement of the Sustainable Development Goals (SDGs)—especially the elimination of poverty and hunger, access to education, reduced inequalities, and improvements in infrastructure—depend on adequate public funding, and efficient government provision. Indeed, the centrality of sound tax and spending policies is encapsulated in SDG 17, which includes strengthening DRM as a subgoal.
Policy objectives of financing public goods and redistribution must be considered within the broader goals of fiscal policy. Rather than a mere vehicle for raising revenue, a strong tax system is an integral part of state capacity building that is essential to promoting broader development (Besley and Persson 2014, Keen and Slemrod 2021). The authority to raise taxes is a defining feature of modern states, underpins the contract between government and society, and is inextricably linked to the development of strong legal frameworks. Since economic transactions are the basis for revenue generation, states seeking to generate more revenue have an incentive to build institutions that support markets and economic development. Moreover, state institutions and tax systems evolve together and reinforce each other. Stronger tax systems provide states with the resources to build strong institutions which, in turn, can simplify tax collection and encourage tax compliance. Finally, state capacity to raise adequate domestic revenues reduces dependence on unstable foreign aid and costly borrowing from private lenders.

Tax and spending policies can support specific public policy objectives. For example, by altering prices and therefore incentives, tax, and other fiscal instruments can be efficient tools for correcting externalities. Classic examples include environmental challenges such as water and air pollution and climate change mitigation. Health taxes can discourage the consumption of tobacco and unhealthy food and beverages, curtailing the incidence of lifestyle diseases. Moreover, while all taxes distort economic activity and impose welfare costs, an efficient tax mix that does not unduly rely on highly distortive taxes which deter investment and employment contributes to strong economic growth, which helps reduce poverty. Equally important is the efficient deployment of government resources to minimize tax burdens and reduce the risk of government spending crowding out productive private spending.
Finally, effective government spending and adequate tax revenues, together with a prudent approach to public debt, can help ensure resilient public finances and counter-cyclical fiscal policy that can promote macroeconomic stability. Indeed, the experiences of the Global Financial Crisis (GFC) and the coronavirus disease (COVID-19) pandemic have challenged long-standing macroeconomic policy orthodoxy that stabilization was primarily the domain of monetary policy (Cottarelli, Gerson, and Senhadji 2014). When interest rates are very low, fiscal policy may prove to be an especially effective macroeconomic stabilization tool (Delong and Summers 2012). During a severe downturn, fiscal policy also gives governments the flexibility to provide targeted economic support to hard hit industries and households. Moreover, as highlighted by the COVID-19 pandemic, during a multifaceted crisis, fiscal policy provides additional policy levers to government to complement broad economic stimulus. More specifically, adequate public support for health care and education has contributed to managing the COVID-19 pandemic and promoting economic recovery.

Across much of developing Asia, particularly East Asia, there is a long history of prudent fiscal policy. Overall, tax revenues and the government sector, measured by the share of public spending in the economy, often have been smaller in Asia than in peer developing regions and high-income economies. Governments have also channeled public resources towards investments in growth-enhancing physical infrastructure and education, rather than social protection and redistribution (ADB 2014). Such public support has enabled the private sector to flourish and drive growth and development. In tandem with lower levels of government spending, fiscal imbalances have also generally been modest, contributing to relatively low public debt levels across developing Asia. While the region’s public debt was generally below 50% of gross domestic product (GDP), much lower than in Latin America and Sub-Saharan Africa (ADB 2020).

In many ways, this fiscal prudence has served the region well, promoting macroeconomic stability and supporting high savings that has underpinned strong investment. These factors, together with the focus on growth-enhancing spending, have supported the rapid growth that has been essential for driving down poverty and lifting general living standards across the region.

However, low fiscal revenues and spending in many developing Asian economies have held back public goods and services in social areas, while weak social protection left the poor vulnerable and exacerbated inequality. The COVID-19 pandemic has exposed chronic weaknesses in health and other areas, with the poor disproportionately affected. Promoting sustainable development requires enormous investments across a swathe of sectors, including education, health, social protection, infrastructure, and climate change adaptation and mitigation. As developing Asia looks to recover from the COVID-19 pandemic and chart a course back to the region’s trademark sustained rapid growth, it is vital that governments address shortfalls in the provision of essential public goods and directly support households to tackle poverty and inequality. This will require increasing the resources that are available to governments, in particular adequate and stable tax revenues.

Framed against these broad policy objectives, the purpose of this paper is to provide an overview of Asia’s fiscal landscape and challenges as the region emerges from the COVID-19 pandemic. Section II takes stock of tax trends in the lead up to COVID-19 and some key implications for government expenditure. To put Asia’s fiscal landscape in context, comparisons are drawn with other developing regions and high-income economies. Section III then provides a preliminary assessment of the impact of the pandemic on taxes and expenditures, while Section IV concludes.
II. DEVELOPING ASIA’S TAX AND EXPENDITURE LANDSCAPE

A. Tax Trends in Developing Asia Prior to COVID-19

Tax revenue data presented in this paper are generally drawn from three sources to maximize data coverage and timeliness, particularly for developing Asia, while also enabling comparisons with a wide variety of other economies. First, wherever possible, we use data from the Revenue Statistics of the Organisation for Economic Co-operation and Development (OECD 2020a), which has superior temporal coverage of tax revenues and subcomponents for 113 economies that are consistently presented on a general government basis. This was supplemented by the International Monetary Fund (IMF) Government Financial Statistics (GFS), which has data for more than 180 economies. Finally, when data for developing Asia are unavailable or incomplete in the OECD or IMF-GFS, we supplement with the Key Indicators Database of the Asian Development Bank (ADB). Data from this database are collected directly from national authorities and are compiled following the GFS methodology. Where possible, we report data on a general government basis, which incorporates central and subnational revenues and spending, or alternatively central government.¹

We focus on analyzing trends in tax-to-GDP ratios. Normalizing revenues as a share of GDP is a simple way to provide a snapshot of the size of revenues available to governments and a way to control for inflation. A drawback of this metric is that revisions to GDP may cause changes in the ratio that are unrelated to tax revenues. Further, comparing tax-to-GDP ratios across a diverse sample of economies ignores important underlying differences in economic structures and institutional features that are likely to have a significant bearing on revenues. At least in theory, such differences can be controlled by examining tax effort, which compares actual tax revenues with the level of revenues predicted by underlying characteristics of an economy. However, while providing important insights, tax effort is influenced by methodological choices and, given greater data needs, will generally be less widely available. Tax-to-GDP ratios offer the advantage of being widely available over time and across economies. To address some of the shortcomings with this metric, we supplement selectively with figures on actual tax revenues and include comparisons with economies of similar development levels.

In the 2 decades prior to the onset of COVID-19 in 2020, developing Asia made gradual progress in raising tax revenues. In the period 2015–2019, the tax-to-GDP ratio of developing Asia, calculated as a simple average, stood at 16%, up from 14% in 2000–2004 (Figure 2). The increase in the years just before the GFC was particularly pronounced, with further small gains in the years immediately prior to COVID-19. Tax-to-GDP ratios also rose in Sub-Saharan Africa and Latin America, albeit more modestly, reaching 16% and 19%, respectively, by 2015–2019. Hence, tax revenues in developing Asia were broadly comparable to Sub-Saharan Africa, but below Latin America just prior to COVID-19. In 2015–2019, the tax-to-GDP ratio for high-income OECD countries stood at 26%, broadly unchanged from 2000 to 2004. Hence, while developing Asia achieved some convergence in tax revenues with OECD countries, they continued to lag well behind, collecting a little more than a third less than OECD countries.

¹ The Online Appendix (http://dx.doi.org/10.22617/WPS220267-2) presents the details on how this database was compiled.
According to GFS definitions, social security contributions (SSC) are treated as nontax revenues but are nonetheless sometimes combined with tax revenues for presentational purposes. For example, OECD statistics on total tax revenues typically include SSCs. With some exceptions, notably the People’s Republic of China (PRC) and the Republic of Korea, SSCs are not particularly large in developing Asia, reflecting underdeveloped social protection systems or a reliance on general revenue to fund social protection. However, SSCs can be quite large, particularly in OECD countries where they often amount to 10% of GDP or more. Therefore, applying a broader definition of tax revenues, which includes SSCs, the gap between developing Asia and OECD countries is even larger.

Across developing Asia subregions, tax revenues varied considerably. They were generally higher in East Asia, Central and West Asia, and the Pacific economies, averaging about 17%, 19%, and 18% of GDP, respectively, and lower in Southeast and South Asia, at 15% and 10% of GDP, respectively. To put these figures in context, developing Asia subregions with the lowest tax-to-GDP ratios collected significantly less tax than the average for other developing regions, including Sub-Saharan Africa. From 2000 to 2004, average tax revenues rose in all developing Asia subregions, with East Asia recording the largest increase. In contrast, tax revenues were more stagnant in South Asia and Southeast Asia.

Across developing Asia tax revenues varied considerably (Figure 3). Developing Asia with the highest tax revenues prior to COVID-19 were generally either the Pacific economies or more advanced developing Asian economies. These include Georgia at 24% of GDP and Fiji at about 23% of GDP.
the Republic of Korea, tax revenues without SSCs stood at 19% but increases to 27% of GDP once SSCs are included. For these economies, levels of revenue are broadly comparable to the United States. Developing Asian economies with the lowest revenues as a percentage of GDP are Bangladesh, Pakistan, and Indonesia, at 9%, 11% and 12%, respectively.

Figure 3: Average Tax Revenue in Selected Asian Economies, 2000–2004 versus 2015–2019

ARM = Armenia; AZE = Azerbaijan; BAN = Bangladesh; BHU = Bhutan; CAM = Cambodia; FIJ = Fiji; GDP = gross domestic product; GEO = Georgia; HKG = Hong Kong, China; IND = India; INO = Indonesia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; MAL = Malaysia; MLD = Maldives; MON = Mongolia; NEP = Nepal; PAK = Pakistan; PHI = Philippines; PNG = Papua New Guinea; PRC = People’s Republic of China; ROK = Republic of Korea; SIN = Singapore; SRI = Sri Lanka; THA = Thailand; VAN = Vanuatu; VIE = Viet Nam.


Except for Kazakhstan, Malaysia, Papua New Guinea, Singapore, and Viet Nam, tax-to-GDP ratios rose across developing Asia in the 2 decades before COVID-19, with the largest increases in Georgia and Nepal. However, despite this widespread progress across the region, tax revenues in several developing Asian economies remained below a widely applied minimum threshold of about 15% of GDP that is associated with improvements in state capacity and growth accelerations (Gaspar, Jaramillo, and Wingender 2016). Moreover, mirroring a global trend, across developing Asia, tax revenues were generally correlated with levels of development, with revenues generally lowest in the poorer economies in the region which also have the greatest spending needs.

Finally, while we focus on tax revenues, it is useful to briefly compare tax and nontax government revenues. The latter includes grants, such as ODA, property income, which incorporates revenue from government-owned assets, sales of goods and services, fines and penalties, and other miscellaneous revenue sources. Except in some smaller, predominantly economies in the Pacific, nontax revenues are generally much smaller than tax revenues in developing Asia. Excluding the Pacific economies, nontax revenues average 8% of GDP in 2015–2019, or less than half the amount of tax revenue. In the case of Pacific economies, the importance of nontax revenues reflects comparatively
high ODA flows and income generated from a narrow range of nontax sources, particularly from fisheries and foreign vessels.

B. Tax Revenue Structures in Developing Asia Prior to COVID-19

As in other developing regions, developing Asia tends to rely heavily on revenues from value-added taxes (VATs), which were widely introduced throughout Asia during the 1980s and the 1990s, and other taxes on goods and services, including excises (Figure 4). In the years just prior to COVID-19, revenues from these consumption-related taxes for developing Asia accounted for about a half of all tax revenue. Of this, about half came from VAT, making it the single most important tax revenue source for developing Asia. These shares are marginally higher than the average for Sub-Saharan Africa and a little lower than the Latin America average.

After consumption taxes, corporate income taxes, which are relatively easy to collect, at least from large firms, account for the next largest share of tax revenue in developing Asia, at about 21%. This share is higher than other developing regions, and much higher than in OECD countries. Personal income taxes account for 13% of revenues in developing Asia, comparable to Latin America but much lower than OECD countries, where they account for 32% of tax revenues. Trade taxes account for about 10% of the tax revenues of developing Asia, comparable to other developing regions but much higher than OECD countries where the share is negligible.

Figure 4: Tax Revenue by Source, 2015–2019

OECD = Organisation for Economic Co-operation and Development.
While comparing revenue shares from different taxes provides a snapshot of their relative importance, it obscures differences in the revenue levels generated by each tax type. Given that developing Asian economies collect less revenues than OECD countries in particular, it is instructive to also compare the level of revenues generated by each tax as a share of GDP across regions. Despite their large share of total revenues, the level of revenue that developing Asian economies generate from VAT and other taxes on goods and services as a percentage of GDP is still lower than OECD countries (Figure 5). In contrast, corporate income tax revenue as a share of GDP is similar in developing Asia, at about 3.4%, to OECD countries. Finally, the level of revenue generated by personal income taxes as a share of GDP in developing Asia, at about 2.1%, is about a quarter the level of OECD countries.

Figure 5: Tax-to-Gross Domestic Product Ratio by Source, 2015–2019, Selected Regions

GDP = gross domestic product, OECD = Organisation for Economic Co-operation and Development.

Across individual developing Asian economies, the reliance on VAT and other consumption taxes is especially high in some smaller economies, accounting for three quarters or more of total tax revenue in Vanuatu, Viet Nam, and Cambodia (Figure 6). In other developing Asian economies, revenues are generally more diversified, with a greater balance between consumption and corporate income taxes. In the vast majority of developing Asia, the personal income tax share of revenues is small and, in relatively few, it generates revenue greater than 2% of GDP (Figure 7).
Figure 6: Tax Revenue Sources in Selected Developing Asian Economies, 2015–2019

Notes: Bhutan recently adopted goods and services tax. Hong Kong, China does not levy VAT. For India, VAT is subsumed under taxes on goods and services, which includes general taxes on goods and services, excise taxes, taxes on specific services, and taxes on the use of or permission to use goods. As no data is available on PIT in Maldives, it is subsumed in other taxes. As no data are available on VAT, CIT, or PIT in Pakistan, VAT is subsumed in other goods and services tax, and CIT and PIT are subsumed in other taxes. Palau does not levy VAT or make available data on CIT, which is subsumed in other taxes. Singapore and Viet Nam report no revenue from international trade tax. Vanuatu reports no revenue from CIT or PIT.

Over the past 2 decades, higher VAT revenues accounted for a significant share of increased revenue in developing Asia. In most developing Asian economies, corporate income taxes also contributed to an overall increase in revenues, despite the pressure from global corporate tax competition. Changes in the share of revenues from other taxes were more mixed.

The progressivity of a tax system depends on detailed policy design, including tax rates and the effective tax base, which will depend on exemptions. Nevertheless, a rough indicator of progressivity is the proportion of tax revenue raised through direct taxes, defined here as personal and corporate income taxes, compared with indirect taxes, encompassing all other taxes. Direct taxes are sometimes considered more progressive, particularly personal income taxes that are applied at a higher marginal rate for higher-income earners, although they are also considered more distortive and, therefore, less efficient (Bhattacharya and Stotsky 2022). In contrast, indirect taxes and particularly consumption taxes, are sometimes considered more regressive but also more efficient.
A tax structure that relies more on direct taxes relative to indirect taxes, therefore, is generally considered more regressive and less efficient. As is the case in other developing regions, in developing Asia direct taxes account for a smaller share of revenues than in high-income economies. In 2015–2019, the share of direct taxes for developing Asia was about 33.6%, compared with 43.7% for OECD countries (Figure 8). Moreover, the proportion of direct tax revenue in developing Asia did not change significantly in the 2 decades before COVID-19. On this broad metric, therefore, tax systems in developing Asian economies are less progressive but more efficient than in high-income economies but a little more progressive than in other developing regions.

![Figure 8: Direct and Indirect Share of Tax Revenues, 2000–2019, Selected Regions](image)

OECD = Organisation for Economic Co-operation and Development.

Note: Direct is the sum of corporate and personal income taxes, while indirect comprise other taxes.


C. Developing Asia’s Public Expenditure Landscape

As noted, in most economies, taxes represent the primary source of government revenue and, therefore, largely define the public expenditure envelope over the medium to longer term. While governments normally spend more than they collect in tax, reflecting borrowing as well as nontax revenue, there is a strong positive correlation between total taxes and spending across developing Asian economies and other economies (Figure 9). In developing Asia, the correlation is much weaker among the Pacific economies. This reflects both unusually high levels of nontax revenues and the high cost of providing government services to remote and dispersed populations, and spending inefficiencies (Cabezon, Tumbarello, and Wu 2015). Given the low average taxes in developing Asia, excluding the Pacific
economies, average public spending of about 27% of GDP is comparable to developing peer regions, but far below OECD countries (Figure 10).

For developing Asia and other economies, tax revenues are more strongly correlated with public spending in areas essential for promoting inclusive development. Indeed, while education, health, and social protection spending rises with tax revenue around the world, higher education and health spending stands out in developing Asia (Figures 11 and 12). Health and social protection spending is especially high in economies where tax revenues exceed 20% of GDP. Excluding the Pacific economies, developing Asia’s education and health spending lags behind not only OECD countries but also other developing regions. Average developing Asia spending on social protection compares a little more favorably to developing peers, but is less than a third of the share of OECD countries. In contrast, defense spending is negatively correlated with taxes, clustered at about 1%–3% of GDP, and on average higher in developing Asia. This suggests that most governments seek to achieve a threshold level of defense spending irrespective of development and tax levels, and that defense spending accounts for a disproportionately high share of outlays in many of the lowest-taxed and poorest economies.
Figure 11: Tax and Spending on Selected Activities as % of Gross Domestic Product, 2015–2019

a. Education spending

b. Health spending

Figure 12: Expenditure on Selected Activities as % of Gross Domestic Product, Selected Regions

a. Education spending

b. Health spending

continued on next page
c. Social protection spending

GDP = gross domestic product, OECD = Organisation for Economic Co-operation and Development.

Note: ● is the average for developing Asia including the Pacific. Education and health expenditure is the 2015–2019 average for each region, and social protection expenditure is 2020 or latest value.


d. Defense spending

GDP = gross domestic product, OECD = Organisation for Economic Co-operation and Development.

While correlation does not imply causation, these trends suggest that increased tax revenue will often be directed towards development-promoting areas, a claim strengthened by more detailed empirical evidence on taxes and health spending (Carter and Cobham 2016, Hall et al. 2021).

### III. THE IMPACT OF COVID-19 AND MEETING THE CHALLENGE OF FISCAL POLICY FOR SUSTAINABLE DEVELOPMENT

#### A. The Impact of COVID-19 on Taxes and Expenditures

COVID-19 caused an unprecedented global health and economic shock which had a profound impact on developing Asia. Necessary containment measures imposed to limit the spread of COVID-19 triggered a massive supply shock to the global economy, halting economic activity and disrupting international trade and supply chains, and international financial flows. In 2020, the global economy contracted and, while faring better than most regions, economic growth turned negative in developing Asia for the first time since 1962. Some economies in the region, particularly where lengthy stringent lockdowns were imposed, or those reliant on disproportionately affected sectors, suffered huge economic contractions. As international tourist arrivals collapsed in 2020, some small tourism-dependent economies shrank at double-digit rates. Despite efforts to control the spread of COVID-19 and bolster health care systems, tragically, as in other parts of the world, developing Asia has endured high numbers of infections and tragic loss of lives.

The impact of COVID-19, which has invariably been hardest for the poorest, has set back progress across key dimensions of development. Sharp economic downturns led to falls in employment and incomes, putting upward pressure on inequality, and progress in reducing absolute poverty has been impeded. In developing Asia, it is estimated that the proportion of people living below the extreme poverty line of $1.90 a day rose by about 2 percentage points in 2020 compared with a no–COVID-19 scenario (ADB 2021a). In addition to the direct health impact of COVID-19, the pandemic disrupted health care systems, including prevention initiatives. Progress with lifting education has been hindered by school closures and, across developing Asia, learning losses are estimated to be the equivalent of about 5% of the region’s GDP in 2020 (ADB 2021a). The pandemic magnified food insecurity and malnutrition, with financially constrained households forced to pare back food consumption.

The macroeconomic policy response to these challenges, to save lives and limit the economic damage, was extraordinary, making extensive use of on-and-off budget fiscal measures that boosted spending and eased tax burdens, complemented by significant monetary policy support. As in many other parts of the world, across developing Asia the fiscal policy response was exceptionally large by historical standards (ADO 2021a). Beyond conventional easing in policy rates and targeted measures to ease liquidity pressures, central banks in many economies, including some in the region, went much further, deploying a variety of measures that incorporated wide-scale asset purchases coupled with forward guidance (World Bank 2021). In some cases, asset purchase programs included government bonds, blurring the traditional line between monetary and fiscal policy (Cerutti and Helbling 2021). While not without risks, these interventions were critical for putting downward pressure on public borrowing costs, expanding fiscal space, and enabling governments to unleash wide ranging tax and spending measures.
Across developing Asia, the discretionary fiscal policy response, as announced on budget fiscal measures in the ADB COVID-19 Policy Database (Felipe and Fullwiler 2020), was invariably large. In many cases, these amounted to 5% or more of GDP, with Fiji, Mongolia, Singapore, and Bhutan unrolling a particularly large set of measures (Figure 13). In almost all economies, packages comprised both tax and spending measures, with the former generally smaller.

**Figure 13: Fiscal Policy Responses to COVID-19 in Selected Developing Asian Economies, as of 15 November 2021**

ARM = Armenia; AZE = Azerbaijan; BAN = Bangladesh; BHU = Bhutan; CAM = Cambodia; GEO = Georgia; GDP = gross domestic product; HKG = Hong Kong, China; IND = India; INO = Indonesia; KAZ = Kazakhstan; KGZ = Kyrgyz Republic; MAL = Malaysia; MLD = Maldives; MON = Mongolia; NEP = Nepal; PAK = Pakistan; PHI = Philippines; PNG = Papua New Guinea; PRC = People’s Republic of China; ROK = Republic of Korea; SIN = Singapore; SRI = Sri Lanka; THA = Thailand; VAN = Vanuatu; VIE = Viet Nam.

Notes: Figures comprise health care and public health measures, and income support through forgone government revenue associated with tax deferral, policy rate reduction, and other adjustments.


In almost all economies, announced fiscal stimulus included increases in health-related spending which in some cases, including Tuvalu and Uzbekistan, accounted for the bulk of the fiscal stimulus. Health spending included outlays on health care facilities to treat COVID-19 cases, covering wages for health professionals, ventilators and other critical medical equipment, and laboratory testing. Several economies allocated additional spending for COVID-19 monitoring and case management, including quarantine and specialized COVID-19 testing facilities. In a few economies, such as Azerbaijan and Kazakhstan, modular complexes were built to cater to COVID-19 patients. Singapore introduced a COVID-19 vaccine injury financial assistance program to aid those who suffered serious vaccine side effects. Outlays for vaccine procurement was an additional major component of health-related spending, including increasingly for pediatric and adolescent vaccinations.

Non-health-related spending focused on directly supporting households and alleviating financial stress, notably income support, and reducing pressure on businesses, including subsidies.
Direct household support initiatives comprised cash transfers, food subsidies, and child benefit payments. Almost all governments distributed food or food cards to vulnerable and low-income families. Most developing Asian economies, including Azerbaijan, Georgia, Indonesia, Maldives, Mongolia, and Nepal, also provided utilities subsidies to affected households. Unemployment assistance also was provided by the government in Azerbaijan, Fiji, and Sri Lanka. The Cook Islands and Mongolia released childcare allowances to vulnerable and low-income families.

Support to business focused on subsidies, including for loan interest repayments, grants, and loan guarantees. In several developing Asian economies, including Malaysia, wage subsidies were also introduced to encourage businesses to retain workers. Bangladesh announced subsidies on interest payments on working capital loans. In some economies, including Brunei Darussalam, Cambodia, and Thailand, financial support was extended to key industries heavily affected by the pandemic, including textiles and tourism. Finally, some economies provided targeted support to farmers and the agriculture sector, including capital grants and subsidies, and bolstered the provision of fertilizers.

Across developing Asia, the balance of non-health spending support between households and business varied with some economies, such as India and Tajikistan, focusing on income support to households. Others, such as the PRC, Mongolia, and Nauru, focused on business subsidies and concessions, and spending on infrastructure projects.

Most developing Asian economies also implemented tax-related measures which in some economies, including Georgia and Viet Nam, represented a very large component of overall fiscal stimulus packages. These measures spanned the full range of major tax categories, including personal income tax, corporate income tax, property, trade, and VAT. In some economies tax-measures were complemented also by nontax revenue measures, such as cuts to, or deferral, of increases in tariffs on electricity, water, and other essential services, and some government surcharges and registration fees.

Economies such as Bhutan, Cambodia, and India implemented tax deferrals on personal and business income taxes, as well as deferral of payment of mandatory contributions including social pensions. Other economies either reduced their tax rates, provided tax exemptions, or waived late fees and interest payments for outstanding tax liabilities. Bhutan, for example, deferred payment of sales tax and customs duty on listed essential items, while Indonesia temporarily removed its luxury tax on sales of some cars to accelerate the recovery of its automotive industry. Some measures aimed to support poorer households; for example, VAT exemptions were implemented for select food products and income tax waivers provided to low-income households. Reflecting a strong focus of fiscal packages on supporting health systems, taxes, customs duties, and tariffs on certain medical equipment and related products were waived in some economies. For example, in Indonesia, special provisions were provided to manufacturers of personal protective equipment and household antiseptic products. VAT exemptions were also applied to necessary medical products in Azerbaijan, while Bangladesh suspended duties and taxes on imports of medical supplies, including protective equipment and test kits.

Across developing Asia, COVID-19 fiscal policy responses were generally designed to provide temporary relief through the worst of the pandemic and, in announcing fiscal support measures, many economies specified that these would apply for a limited period before expiring. This helped reduce uncertainty for households and businesses and the risk that measures would become entrenched and create an enduring impost on government finances.

Many spending initiatives comprised one-off payments or outlays for specific projects such as health-related infrastructure. While some household and business income support measures were
intended to apply for a matter of months, others, including some large initiatives, were to last much longer. Indeed, Cambodia’s cash transfer for poor and vulnerable households and affected businesses continues to be implemented and regularly evaluated. Similarly, some types of tax and other revenue relief measures applied for whole fiscal years while others for shorter durations. The Lao People’s Democratic Republic deferred tax collection from tourism-related businesses for 3 months. Viet Nam deferred VAT, corporate and income taxes, and land rental payments for 5 months to support affected businesses and individuals, while the PRC allowed for a 6-month deferral of corporate income tax payment for small enterprises and self-employed businesses. By comparison, the Philippines announced that the net operating loss of a business or enterprise incurred in 2020 and 2021 could be carried over for the next 5 years.

Large discretionary fiscal policy responses together with the collapse in economic activity caused a sharp fall in tax receipts across developing Asia in 2020 (Figure 14). These falls were generally correlated with broader economic conditions, with revenues falling furthest in some small island economies including Fiji and Maldives, as well as other hard-hit economies such as Indonesia, Malaysia, and Sri Lanka. Limited data on individual taxes for developing Asia in 2020 indicates that revenue declines were broad based. For example, according to ADB’s Key Indicators Database, personal income tax receipt collapsed by 83% and corporate income tax receipt collapsed by 32% in Sri Lanka, and fell sharply in the Philippines and Armenia.

Figure 14: Change in Tax Revenues from 2019 to 2020, Selected Developing Asian Economies


At the same time, significant increases in expenditures were recorded in most developing Asian economies (Figure 15). Consistent with stimulus announcements, limited data suggests health spending rose strongly; for example, rising 15.2% and 13.6%, respectively, in the PRC and Indonesia (ADB 2021c). Spending on social protection also rose strongly, notably in Indonesia and Uzbekistan where it increased by 50% and 60%, respectively.2

Figure 15: Change in Expenditure from 2019 to 2020, Selected Developing Asian Economies

<table>
<thead>
<tr>
<th>Country Abbreviation</th>
<th>Change in Expenditure</th>
</tr>
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<tbody>
<tr>
<td>ARM</td>
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<td>BAN</td>
<td>Bangladesh</td>
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<td>KGZ</td>
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<td>KIR</td>
<td>Kiribati</td>
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<td>LAO</td>
<td>Lao People's Democratic Republic</td>
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<td>PHI</td>
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<td>PNG</td>
<td>Papua New Guinea</td>
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<td>PRC</td>
<td>People's Republic of China</td>
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<tr>
<td>RMI</td>
<td>Republic of the Marshall Islands</td>
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<td>SAM</td>
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<td>VAN</td>
<td>Vanuatu</td>
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<td>VIE</td>
<td>Viet Nam</td>
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</tbody>
</table>

ARM = Armenia, BAN = Bangladesh, BHU = Bhutan, CAM = Cambodia, FIJ = Fiji, GEO = Georgia, INO = Indonesia, KAZ = Kazakhstan, KGZ = Kyrgyz Republic, KIR = Kiribati, LAO = Lao People’s Democratic Republic, MAL = Malaysia, MLD = Maldives, MON = Mongolia, NEP = Nepal, PAK = Pakistan, PAL = Palau, PHI = Philippines, PNG = Papua New Guinea, PRC = People’s Republic of China; RMI = Republic of the Marshall Islands, SAM = Samoa, SIN = Singapore, SOL = Solomon Islands, SRI = Sri Lanka, TAJ = Tajikistan, THA = Thailand, TON = Tonga, UZB = Uzbekistan, VAN = Vanuatu, VIE = Viet Nam.


Weaker revenues and higher spending saw fiscal deficits widen in most economies in the region, on average from 1.8% of GDP in 2019 to 6.4% of GDP in 2021 (Figure 16). In general, the economies that experienced the biggest falls in output and revenues saw the largest increases in deficits. In many cases, this increase was larger than following the GFC, when as during the COVID-19 pandemic, governments in the region deployed large fiscal stimulus to counter the effects of a major economic downturn.

Higher fiscal deficits have, in turn, led to a marked increase in government debt levels. For developing Asia as a whole, average public gross debt rose from 51.9% of GDP in 2019 to 65.3% in 2021 (footnote 1). While debt levels in many developing Asian economies remain low by global standards, in some, it has reached uncomfortable levels and is projected to rise further in the coming years, continuing an upward trend that proceeded the pandemic (Ferrarini, Giugale, and Pradelli 2022). A further concern is that, even if public debt levels are relatively modest, private debt in many economies in the region is more substantial and continuing to rise. To the extent that governments may be forced to backstop private borrowers that face debt distress, headline public debt figures will understate government balance sheet pressures.

As developing Asia continue to recover from the pandemic, fiscal consolidation will be required in many economies to restore fiscal sustainability. While an emerging new fiscal policy orthodoxy argues that economies may have more room to maneuver before consolidation is required, debt limits nevertheless remain and the case for ongoing deficits is weaker in many developing economies where underlying demand is strong (Blanchard, Felman, and Subramanian 2021). It will also be necessary to ensure that lifeline measures for businesses are appropriately wound back to avoid supporting zombie firms that are kept afloat by policy support that could impede a strong durable recovery (Favara, Minoiu, and Perez-Orive 2021).

The urgency and magnitude of the consolidation task will depend on economy-specific factors, particularly the size of the deficit and the adjustment needed to stabilize debt, which in turn will be influenced by the outlook for growth and interest rates. So far, across the region, low interest rates and supportive financial conditions, combined with economic recoveries, are underpinning...
relatively favorable debt dynamics and dampening debt pressures. However, global interest rates are rising from very low levels as central banks normalize monetary policy. There is a risk that interest rates could rise suddenly in response to building inflationary pressures, causing an abrupt tightening in financial conditions and a deterioration in debt sustainability (Kose et al. 2021). While inflation across developing Asia is generally expected to remain at comfortable levels, in advanced economies, where recoveries have proceeded more quickly, and labor markets that have tightened, the inflation outlook is less benign (ADB 2022).

B. Meeting the Challenge of Fiscal Policy for Sustainable Development

Developing Asia, therefore, emerges from COVID-19 in a significantly weakened fiscal position, with higher deficits and debt and facing a difficult balancing act to maintain fiscal stimulus where necessary, while safeguarding fiscal sustainability. Tax buoyancy should help strengthen revenues as economic recovery gains traction. As noted in Section III.A, some elements of stimulus packages which were time limited will also begin to unwind, providing a further lift to revenues while reducing spending pressures. However, there is a risk that the pandemic will cast a long shadow over government finances and that spending remains elevated, revenues weak, and deficits wide. The challenge of managing COVID-19 may endure, particularly in economies where vaccine rollouts are slow, requiring governments to maintain household and business support measures and additional funding for health care for longer than anticipated. Long-term output losses would also lower tax revenues. Despite strong growth rebounds, output is expected to remain below pre-pandemic trends for some time in many developing Asian economies (ADB 2022). There is also a risk that the pandemic permanently lowers potential output through its impact on employment, capital accumulation, and productivity (Fernald and Li 2021). Tax compliance can fall during crises, which may slow the pickup in revenues through the recovery from COVID-19 (Brondolo 2009). Finally, even if economies enjoy a strong recovery and stimulus is no longer needed governments may find it politically difficult to implement painful fiscal consolidation.

Beyond managing the pandemic, recovery, and fiscal consolidation, developing Asia faces huge medium-term and longer-term public spending pressures. While mobilizing resources is a long-standing and widely recognized development challenge, the establishment of the United Nations Sustainable Development Goals in 2014 turned attention to the resource requirements of achieving these goals by 2030. Subsequently, several studies estimated these spending needs in key sectors and in aggregate for individual economies and regions (UNCTAD 2014, Doumbia and Lauridsen 2019, Gaspar et al. 2019, and OECD 2020b). The result is that, even before COVID-19, achieving the SDGs by 2030 was estimated to require annual investments of $3.0 trillion–$4.5 trillion, with very large amounts needed in sectors such as energy, climate change mitigation, water and sanitation, education, and health. With actual investment of about $1.5 trillion, this implied spending shortfalls of about $2.5 trillion globally. According to the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP 2019), the Asia and Pacific region alone needed to invest an additional $1.5 trillion annually. According to IMF estimates, average estimated spending shortfalls amount to about 9% of GDP for a sample of developing Asian economies (ADB 2022).

Adding to the challenges, actual spending levels are lower, required spending higher, and hence spending shortfalls are greatest in the least-developed economies. According to Gaspar et al. (2019), the average shortfall in low-income economies amounted to about 15% of GDP. By comparison, spending shortfalls in emerging market economies were about 4% of GDP, more modest but still a significant gap. In addition, while the recovery path from COVID-19 remains uncertain, estimates indicate that SDG
spending shortfalls rose considerably because of the pandemic. Based on a small sample of developing economies, including Cambodia and Pakistan, Benedek et al. (2021) estimate that spending shortfalls may have increased by about 2.5 percentage points of GDP because of lower revenues.

Beyond the medium-term SDG 2030 targets, developing Asia faces longer-term challenges that will impose additional financial burdens for decades to come, notably relating to climate change and aging. Achieving net-zero emissions by 2050 will require massive investments in clean energy (IEA 2021). Developing Asia is aging fast and, in the decades ahead, demographic change will add considerable fiscal pressures. Demands will mount for increased spending on pensions and health care and other services to support the elderly. At the same time, the working age share of the population will shrink in many economies, pushing up the dependency ratio and putting additional pressure on public support.

Given the magnitude of these spending pressures, economies will need to draw on the full range of public and private financial resources at their disposal. Private finance, both domestic and foreign, has a critical role to play. This includes green and social finance from private sources which has been growing strongly, driven by the environmental and social goals of investors as well as financial goals (ADB 2021a). Private finance is likely to be especially prominent in more developed economies where the enabling environment for private investors is stronger. Private investment will also flow more readily into energy and other sectors where returns on investment are more certain, and where there is a longer tradition of private sector involvement.

However, there is a risk that COVID-19 will cast a long shadow not just over government finances but also private financial flows. In 2020, global foreign direct investment flows fell by 35% and all but one SDG investment sector registered double-digit declines (UNCTAD 2021). While flows to developing Asia were far more resilient, excluding the PRC and Hong Kong, China, the region suffered a decline. If economic recovery is protracted, the recovery of foreign direct investment and other private investment could be slow. Remittances, another key source of external private finance for many developing Asian economies was also hit hard by COVID-19 because of the global downturn and international border closures, and may take time to fully recover (ADB 2021b).

Moreover, the role of government as the provider of many public goods and services, particularly to the poor, cannot be completely supplanted by the private sector. Opportunities for private investment in some sectors will often be limited because of underdeveloped institutions or market infrastructure, or because of restrictions on private investment. These especially include education, health, and water and sanitation in rural and remote areas, and climate change adaptation. Taking a longer-term view, as post–COVID-19 growth and development resumes across the region, Asian societies may demand greater public goods and redistribution, as hypothesized by “Wagner’s Law” (Akitoby et al. 2006).

Across developing Asia, several trends therefore point to substantially higher future government spending, which will inevitably require mobilizing taxes to ensure a reliable and growing flow of revenues. The need for both higher spending and taxes is especially great in many of the region’s poorest economies where, notwithstanding progress over the past couple of decades, tax revenues remain at very low levels. A central challenge is for governments to raise these additional revenues without sacrificing the economic growth that the region still desperately needs to reduce poverty and raise living standards (ADB 2022). As spending rises, to minimize the tax burden, it will be important for governments to improve spending efficiency, given large differences in spending effectiveness across economies in key areas such as health and education (Herrera and Pang 2005; Kapsoli and Teodoru 2017; Grigoli and Kapsoli 2018; Clements, Gupta, and Jalles 2022).
IV. CONCLUSION

Central to promoting sustainable development in developing Asia is securing adequate tax revenues by governments to fund public expenditures. This paper takes stock of the region’s fiscal landscape, including a preliminary assessment of the impact of COVID-19, and highlights the broad fiscal policy challenges that are being faced by the region. While tax revenues steadily rose in the decades prior to the onset of COVID-19, they continue to lag well behind high-income economies and some developing peers. The region continues to rely predominantly on indirect taxes, particularly relatively efficient consumption taxes. However, developing Asia’s tax structure is less progressive compared to high-income economies. Government expenditures on education and health, vital for promoting equitable growth, were comparatively modest. Substantial fiscal policy stimulus in response to COVID-19, combined with the impact of the downturn on revenues, has severely weakened public finances in many economies. The combination of falling revenues and higher spending during COVID-19 has markedly widened deficits and caused a further rise in debt levels that were already rising. As the pandemic recedes, governments will need to carefully calibrate fiscal consolidation to safeguard fiscal sustainability while protecting the poor and vulnerable. Beyond the near term, governments across developing Asia face vast public spending needs that will require stronger tax revenues, which is why strengthening tax revenues for sustainable development will remain a key policy challenge in the coming decades.
REFERENCES


References


Developing Asia’s Fiscal Landscape and Challenges

Analysis drawing on newly compiled data shows that while tax revenues in developing Asia steadily rose in the 2 decades before the coronavirus disease (COVID–19) pandemic, they continued to lag well behind high-income economies and some developing peers. The region relies on indirect taxes, creating a relatively efficient but less progressive tax structure, while government expenditures on education and health were comparatively modest. Substantial fiscal policy stimulus in response to COVID–19, combined with the impact of the downturn on revenues, has severely weakened public finances in many developing Asian economies.

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