Making Fiscal Policy Work for the Poor

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Preface

This paper is a synthesis of the fiscal policy chapters of a series of country reports carried out by the UNDP as part of the **Asia-Pacific Regional Programme on Macroeconomics of Poverty Reduction (henceforth MPAP)**. The synthesis focuses on the fiscal policy chapters of the reports and treats other topics in as far as they have major implications for fiscal policy. There is no separate treatment of monetary policy, since this important topic as a synthesis paper of its own. Where relevant, monetary issues a mentioned in the text.

Executive Summary

Introduction

Macroeconomic policies represent a key 'entry point' for the UNDP's activities to foster human development. In order to present countries with viable macro policy options, UNDP supports access to policy advice that presents a menu of feasible options that respond to three policy themes.

UNDP's Asia-Pacific Regional Programme on Macroeconomics of Poverty Reduction (henceforth MPAP) is based on the analytical premise that fiscal policy is a major instrument to generate a pattern of growth that maximises poverty reduction subject to the constraining circumstances in each country; in other words, fiscal policy should foster pro-poor growth. Pro-poor growth itself implies that the poor, however defined in the national context, disproportionately benefit in each period's growth increment. Achieving this outcome requires measures that assure the pro-poor distribution of that increment.

First, while macroeconomic instability usually harms the poor, policy frameworks aimed exclusively to securing such stability do not necessarily benefit the poor. Second, a option sometimes neglected involves giving greater emphasis to fiscal expansion through increasing public investment. While such fiscal expansion may generate government deficits, there is no longer a consensus that these are necessarily inflationary. UNDP supports forms of public investment that can provide a more long-term, durable basis for human development and poverty reduction. This implies capital accumulation and technological innovation that can deliver lasting gains to the poor. Third, inequality has been rising throughout developing and industrial countries in the 1990s. The reasons for rising inequality are still being debated. Skill-based technological change seems to explain part of the phenomenon within countries. The weakening of labour unions and labour legislation, such as on minimum wages, has also contributed to widening disparities, particularly in middle-income developing countries. The policy implication of this rise in inequality is that fiscal measures are necessary to generate growth which is pro-poor.

Much of the focus of traditional pro-poor fiscal analysis has been on expenditure switching policies that alter the pattern of government spending in favour of pro-poor public goods. However, budget re-allocations are not sufficient to have a substantial impact on poverty when the distribution of productive assets is highly unequal. In these circumstances, policies that directly redistribute assets, such as land reform or construction of low-income housing, are essential initiatives.

High inequality can impede the economic performance of a country by obstructing the formation of governance structures that enhance productivity. Where this is the case, inequality is likely to be the result of a distribution of property rights that is inefficient as well as inequitable. If so, there may be a plausible set of alternative distributions that are both more equitable and more efficient; i.e., which foster competition on the basis of a more 'level playing field'.

Public Investment-led Growth

The seven MPAP reports synthesised in this paper share a common theoretical approach. They all define pro-poor growth as growth that, at a minimum, generates a growth increment in which the poor receive an increased share.

All the case studies call for an active fiscal policy to promote growth, greater equity in distribution, and, through these, poverty reduction and human development. In each country pursuit of these goals occurs in the context in different constraints. The careful analysis of the constraints on fiscal intervention for growth, redistribution and poverty reduction is perhaps the most important contribution of the reports. A central theme coming out of all the reports is that in no country studied is policy so constrained that active and innovative fiscal policies are not possible and feasible.

A key fiscal measure stressed in all the reports is the importance of public sector investment. All the reports stress the importance of the crowding-in effect of government investment over crowding-out effects. Public investment is the necessary ingredient in a pro-poor macro strategy, serving three benign purposes: demand management, capacity creation, and redistribution. In the absence of a robust public investment programme, the pro-poor element in fiscal policy is reduced to counter-cyclical interventions, progressive taxation, and redistributive expenditure, all from the current budget. While each of these is important, in many developing countries the capacity to implement the latter two is quite limited. The progressiveness of the tax system is typically constrained by the relative low contribution of the formal sector to income generation, and redistributive current expenditure may be beyond the administrative capacity of the public sector.

Perhaps most important, basing a redistribution strategy on the current budget is not a growth strategy. If sustained, it may create a new, more equal distribution which the economy will approach. However, except for a possible one-off impetus resulting from the positive incentives to the poor of redistribution, it has little impact on the sustainable growth rate. For this reason, public investment is the *sine qua non* of a pro-poor growth strategy, and the reduction of public investment undermines that strategy.

Fiscal Issues for Pro-poor Growth

Sound Fiscal Policy: Every government must maintain a sustainable fiscal policy, which includes a deficit that is manageable in the short term, and the associated public debt it creates being serviceable. The case studies show that 'sound fiscal policy' involves much more than this. The economic function of government is not merely to maintain a stable macro environment; its primary responsibility to its citizens is to foster the general welfare. A deficit target should not be set that undermines a government's ability to achieve the latter.
Social expenditure: The case studies show that increasing expenditure on social sectors is almost always pro-poor. However, pro-poor expenditure switching is more complicated than a relative increase in allocations to social sectors. In Bangladesh, Cambodia, and Nepal, this expenditure switching was associated, in varying degrees, with a fall in public expenditure on economic sectors. As a result, the expenditure switching may have reduced the long-term growth potential of these countries.
Transitional Economies: In an environment in which fundamental change must occur to institutionalise market processes, it is unrealistic in the extreme to think that achieving macroeconomic stability, in the sense of low inflation and low fiscal deficits, will in itself foster private investment, domestic or foreign. The lesson from China and Vietnam is that successful transitions that generate private sector confidence require a purposeful government with an active fiscal policy whose key element is public investment.

Pro-poor fiscal instruments

The case studies suggest the following conclusions on fiscal instruments.
1. The virtues of the value added tax (VAT) are greatly exaggerated, and its negative aspects insufficiently appreciated. Among its other drawbacks, the VAT is not pro-poor.
2. Donor and lender conditionalities have tended to apply a more restrict standard for deficits that are used in the developed countries themselves; a notable example is overruling the economic case for deficit finance of public investment.
3. A flexible approach to public sector deficits would allow for a range of mechanisms to raise domestic resources for investment.

I. Analytical Framework

A. Introduction

Macroeconomic policies represent a key 'entry point' for the UNDP's activities to foster human development. In order to present programme countries with viable macro policy options, UNDP seeks to support access to policy advice that presents a menu of feasible options and alternative analyses. In supporting such activities UNDP seeks to respond to three policy themes.

First, and particularly since the Asian crisis there is a general recognition that while macroeconomic instability usually harms the poor, policy frameworks geared exclusively to securing such stability do not necessarily benefit them. Much depends on how stability is achieved, at what cost and to whose benefit.

Second many development economists now recognize the value of offering governments a menu of economic policy options. One option, previously neglected, involves giving greater emphasis to fiscal expansion through increasing public investment that can stimulate growth. While such fiscal expansion can generate government deficits, there is no longer a consensus that these are necessarily inflationary. Also, as long as inflation is kept within a moderate range, it does not necessarily dampen growth or directly harm the poor.[3]

While advocating greater flexibility on stabilization policies, UNDP supports forms of public investment that can provide a more long-term, durable basis for human development and poverty reduction. This implies capital accumulation and technological innovation that can deliver lasting gains to the poor, examples of which are found in the country reports. Policy that fosters sustainable growth must shift emphasis in national poverty reduction strategies from short-term

[3] Bruno and Easterly find no correlation between growth and inflation when the latter is below forty percent (Bruno & Easterly 1998).

targeted interventions to longer-term programmes that alter the underlying structure of people's access to resources and technology.

Third, inequality has been rising throughout developing and industrial countries in the 1990s. A UNDP-supported study by the World Institute for Development Economics Research documents that inequality has risen in two-thirds of the countries for which reliable data are available. A more recent World Bank study also shows that world inequality, across as well as within countries, has been on the rise. The reasons for rising inequality are still being debated. Skill-based technological change seems to explain part of the phenomenon within countries. The weakening of labour unions and labour legislation, such as on minimum wages, has also contributed to widening disparities, particularly in middle-income developing countries. The policy implication of this rise in inequality is that fiscal measures are necessary to generate growth which is pro-poor.

Much of the focus of traditional pro-poor fiscal analysis has been on expenditure switching policies that alter the pattern of government spending in favour of pro-poor public goods. However, budget re-allocations are not sufficient to have a substantial impact on poverty when the distribution of productive assets is highly unequal. In these circumstances, policies that directly redistribute assets, such as land reform or construction of low-income housing, are essential initiatives. In some case redistribution of assets and increasing the opportunities of the poor to create assets is more compatible with stimulating growth than redistribution of income, because the former creates less distortion in economic incentives.

High inequality can impede the economic performance of a country by obstructing the formation of governance structures that enhance productivity. Where this is the case, inequality is likely to be the result of a distribution of property rights that is inefficient as well as inequitable. If so, there may be a plausible set of alternative distributions that are both more equitable and more

efficient; i.e., which foster competition on the basis of a more 'level playing field'.

UNDP's MPAP is based on the analytical premise that fiscal policy is a major instrument to generate a pattern of growth that maximises poverty reduction subject to the constraining circumstances in each country; in other words, fiscal policy should foster pro-poor growth. Pro-poor growth itself implies that the poor, however defined in the national context, disproportionately benefit in each period's growth increment. Achieving this outcome requires measures that assure the pro-poor distribution of that increment.

B. Public Investment-led Growth

The seven MPAP reports synthesised in this paper[4] share a common theoretical approach. They all define pro-poor growth as growth that, at a minimum, generates a growth increment in which the poor receive an increased share.[5]

Thus, all the case studies call for an active fiscal policy to promote growth, greater equity in distribution, and, through these, poverty reduction and human development. In each country pursuit of these goals occurs in the context in different constraints. The careful analysis of the constraints on fiscal intervention for growth, redistribution and poverty reduction is perhaps the most important contribution of the reports. A central theme coming out of all the reports is that in no country studied is policy so constrained that active and innovative fiscal policies are not possible and feasible.

A key fiscal measure stressed in all the reports is the importance of public sector investment. All the reports stress the importance of the crowding-in effect of government investment over crowding-out effects. Crowding out effects occur

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[4] The Sri Lanka report is yet to be completed

[5] Stated formally, this means: $\Delta Y_p/\Delta Y > Y_p/Y$, where Y is aggregate disposable income, Y_p is the income of the poor, and Δ indicates the absolute change between two periods.

when an increase in any component of aggregate demand (e.g., government investment) must be compensated by a decrease in some other component (e.g., private investment. This proposition follows automatically if financial markets are assumed to be in equilibrium, a common assumption in many macroeconomic policy frameworks.

If financial markets are *not* in equilibrium, and there exist supply side bottlenecks and/or demand constraints, then the impact of increased government expenditure on the components of private demand is an empirical question. The reports conclude that to varying degrees the net effect of government expenditure, especially government investment, is to crowd-in private expenditure through the familiar multiplier effect, the impact on profit expectations, and cost reductions associated with improved infrastructure. For the same analytical reasons, the reports emphasise the importance of improving public resource mobilisation rather than viewing public sector resource mobilisation as a 'burden' on private initiative.

In summary the analytical framework used in the MPAP results in an empirical approach to fiscal policy. Within this framework, the function of fiscal policy is to achieve an economy's potential and sustainable growth rate, and redistribute income at the margin in order to increase the elasticity of poverty reduction with respect to growth. Public investment is the key to these goals, since it increases capacity, and can be designed to do so in a way that biases income gains to the poor.

C. Growth and Distribution: Distribution matters

Before proceeding to the case studies, it is important to engage with some postulations about growth and distribution that are treated as "stylised facts" in many policy documents on the subject. One such postulate is that some countries are 'too poor to redistribute'; that is, their per capita income is so low that redistribution would have little impact on the level of poverty. The MPAP finds

no empirical evidence to support this proposition (Also see Dagdeviren, van der Hoeven, & Weeks, 2002). A complementary postulate is that there is a 'trade-off' between redistributing income and the aggregate growth of income. A milder version of this postulate is that while distribution may achieve a degree of poverty reduction, economic growth does so in a more sustained manner. The fallacy in both versions of the distribution-versus-growth argument is that in practice, growth in market economies is always associated with some degree of redistribution. Market economies allocate resources through the price mechanism, be this through competitive or privately-administered markets. Thus, the distinction between distribution neutral growth and static income redistribution exists only as a mental construct. Since redistribution of income is inherent in the growth of a market economy, it is appropriate that it be subjected to policy influence.

An evaluation of the effectiveness of growth and distribution for poverty reduction would be required even were it the case that for the vast majority of countries historical growth rates would achieve the poverty target (see van der Hoeven 2000). Any target growth rate, in this case for poverty reduction, has an opportunity cost in foregone consumption compared to lower rates. This real resource cost can be compared to the cost of achieving the same poverty reduction at a lower growth rate. Economic growth is a means, and raising the rate of economic growth without considering the opportunity cost would be the domestic equivalent of mercantilism.

The relevance of the opportunity cost of raising growth rates passes from academic to practical interest because, for the vast majority of countries, maintaining recent growth rates would not be sufficient to meet the Millennium poverty targets,[6] including four of the seven countries covered by this synthesis (Cambodia, Indonesia, Mongolia and Nepal). With this in mind, we consider the impact on poverty of growth and redistribution in a simple analytical framework (for an elaboration, see Weeks 2003). Using an absolute poverty line, such as that which is the basis of the first Millennium Development Goal, we define the

[6] A discussion of this issue is found in Demery & Walton (1998).

income distribution of a country over the adult population, which we divide into percentiles (h_i), and the mean income of each percentile is Y_i. The distribution of current income conforms to the following two parameter function:

(1) $Y_i = Ah_i^{\alpha}$

While this function will tend to be inaccurate at the ends of the distribution, its simplicity allows for a straight-forward demonstration of the poverty impact of distribution and growth. Each country's distribution differs by the degree of inequality (the parameter α) and the scalar A, which is determined by overall per capita income. Thus,

(2) $A = \beta Y_{pc}$

and

(3) $Y_i = \beta Y_{pc} h_i^{\alpha}$

Total income is, by definition,

(4) $Z = m\sum \beta Y_{pc} h_i^{\alpha}$ for 1 = 1,2...100, and m is the number of people in each percentile.

If the poverty line is $Y_p = P$, we can solve for the percentile in which it falls, which is also the percentage in poverty (N).[7]

(5) $h_p = N = [P/\beta Y_{pc}]^{(1/\alpha)}$

If we differentiate N with respect to per capita income, we can express the proportional change in the percentage of the population in poverty in terms of the growth rate of GDP and the distributional parameters:[8]

(6) $DN/N = n = y[1/\alpha][P/\beta]^{(1/\alpha)}$

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[7] A characteristic of this distribution function is that the two parameters, α and β, are not independent of each other. This characteristic does not affect our calculations in the next section, because we use the function only for the initial period's income.

[8] Ravallion (2001, p. 19) proposes that this relationship can be estimated with the simple formula,

$$n = \beta(1 - G)y$$

With β an unspecified parameter and G the Gini coefficient of distribution. For a number of countries, he calculates the value of β, which he calls 'the elasticity of poverty to growth'. On this basis he obtains a cross-country average for β of –3.74. Since the formula does not specify on what distribution function it is based, it is not clear how one should interpret this so-called elasticity. At most the formula could be considered a rough algorithm for the appropriate relationship among the variables.

Equation 5 can be used to generate a family of iso-poverty curves, of decreasing level as they shift to the right, shown in Figure 1, on the assumption that α is constant. The diagram clarifies the policy alternatives: redistribution of current income (RCY) involves a vertical (downward) movement, distribution neutral growth (DNG) a horizontal (rightward) shift, and RWG is represented by a vector lying between the two. The diagram also shows the case of increasing inequality growth (IIG), in which the growth of per capita income so worsens the distribution of income that it leaves poverty unchanged (movement along the constant poverty level curve for P = 20 percent). Perhaps too optimistically, we do not treat this as a planned outcome, since we address policies to reduce poverty.

The diagram implies certain generalisations that apply to all countries. First, because the schedules converge to the left, the impact of redistribution on poverty *declines* as per capita income declines. At low incomes, both redistribution and redistribution with growth are less effective, relatively to distribution neutral growth. Second, for a given per capita income, the lower the level of inequality,[9] the greater is the impact of redistribution on poverty reduction. When the poor are clustered close to the poverty line, the income transfer necessary to raise them out of poverty is less than if the same number of households were unequally distributed.

The growth-distribution interaction on poverty reduction can also be shown for growth rates, using equation 6. In Figure 2, the percentage reduction in poverty is on the vertical axis and growth rates on the horizontal. Three lines are shown, for increasing degrees of inequality as they rotate clockwise (increasing values of α, holding initial per capita income constant). The figure shows that for any initial per capita income, growth reduces poverty more, the less the inequality of initial income distribution. From the initial position at point a, distribution neutral growth increases the rate of poverty reduction along the schedule a = 1.3 to point b (an increase in the growth rate with distribution

[9] The model specifies the slope of the distribution function near the poverty line with the parameter α, along with it being an index of overall inequality.

unchanged), redistribution of current income involves a vertical movement to point c, and a shift from point a to point d is a case of redistribution with growth.

Assuming all income distributions to be relatively continuous,[10] any distribution neutral growth in per capita income, no matter how low, will reduce poverty. However, redistribution reduces poverty as measured by the international standard of US$ one dollar a day only if it moves a person above a per capita income of US$ 365. To put the point another way, redistributions that reduce the degree of income poverty for those below an arbitrary poverty line poverty standard do not qualify as poverty reducing.[11]

We can link the discussion of public investment to this model of distribution and growth. In a pro-poor strategy, the task of public investment, in addition to its demand and capacity effects, is to generate a distribution each time period's growth increment that is more equal than the distribution in the initial period. In symbols:

$S_p = h_p Y_p$, the income share of the poor, where Y_p is mean income for all those households (h_p) below the poverty line, and S_{np} is the income share above the poverty line, growth is pro-poor if:

$[\Delta S_p / \Delta S_{np}] > [S_p / S_{np}]_t$ where the increment refers to the increase from period t to t+1.

Public investment contributes to this outcome by creating assets that foster income earning opportunities for the poor. This can include the following: 1) public works projects that directly hire the poor, 2) increases in the wages of the poor engaged in other activities as a result of public sector projects leading to a tighter labour market; 3) creation of infrastructure assets that gives the poor access to markets and lowers their production costs; and 4) social sector assets

[10] That is, we assume there are no 'gaps' in the distribution below and near the poverty line.

[11] A redistribution of one percentage point of GDP from the richest ten percent of the population to the poorest ten percent, equally distributed among the latter, would improve raise the incomes of all those in the lowest decile, but might shift none of them above the poverty line.

such as schools and health clinics that increase the productiveness of the poor, as well as facilitating their participation and integration into the political system.

D. Summary

Public investment is the necessary ingredient in a pro-poor macro strategy, serving three benign purposes: demand management, capacity creation, and redistribution. In the absence of a robust public investment programme, the pro-poor element in fiscal policy is reduced to counter-cyclical interventions, progressive taxation, and redistributive expenditure, all from the current budget. While each of these is important, in many developing countries the capacity to implement the latter two is quite limited. The progressiveness of the tax system is typically constrained by the relative low contribution of the formal sector to income generation, and redistributive current expenditure may be beyond the administrative capacity of the public sector.

Perhaps most important, basing a redistribution strategy on the current budget is not a growth strategy. If sustained, it may create a new, more equal distribution which the economy will approach. However, except for a possible one-off impetus resulting from the positive incentives to the poor of redistribution, it has little impact on the sustainable growth rate. For this reason, public investment is the *sine qua non* of a pro-poor growth strategy, and the reduction of public investment undermines that strategy.

II. Summary of Key Issues by Country

Prior to treating fiscal policy in detail, it is necessary to assess the economic performance of each country with respect to major indicators. These provide a guide to the constraints within which policy makers can act to foster

growth and redistribution to achieve poverty reduction. This assessment allows one to identify the major fiscal issues for each country.

Table 1 shows for each country the record on poverty reduction, changes in inequality, growth per capita, inflation, and the overall fiscal deficit during the 1990s and through the latest statistics that were available when this report was written. With regard to poverty reduction, the most important indicator of economic performance, the countries fall into two clear categories: those that have achieved sustained improvement (Bangladesh, and especially China and Vietnam), and those in which poverty has increased or not declined (Cambodia, Indonesia, Mongolia and Nepal).

The obvious importance of growth to poverty reduction is demonstrated in the three countries in which the head count ratio declined by ten percentage points or more. These countries also demonstrate the importance of distribution, for in each case the growth-induced decline in poverty was reduced substantially by the growth-induced increase in inequality. In Vietnam, had growth between 1993 and 1998 been distribution-neutral, the percentage point fall in headcount poverty would have been thirty-one rather than the actual twenty-one. If one makes the strong assumption that a higher growth rate in Vietnam would not have resulted in even greater inequality, a *ceterius paribus* calculation indicates that per capita growth of 7.4 percent per annum would have been required to achieve the same reduction in poverty. These additional 2.4 percentage points in the growth rate would have required an increase in investment of seven to ten percentage points of GDP (assuming the incremental capital output ratio to lie between three and four). This increase would have come at the expense of government consumption expenditures, including social transfers which could have an adverse effect on poverty. Increasing inequality of income distribution is not only socially dysfunctional; it makes poverty reduction increasingly expensive.

One can conclude that for China and Vietnam growth has been more than adequate to achieve rapid poverty reduction, and the major task of fiscal policy is to make growth more pro-poor. Even the relatively modest goal of distribution

neutral growth would have a dramatic impact on growth generated poverty reduction. In contrast, for Cambodia, Mongolia and Nepal growth rates were too low for satisfactory poverty reduction. For example, if the growth rates of the late 1990s and early 2000s continue through the decade, none of the three would achieve the Millennium Development Goal of reducing extreme poverty by half by 2015 even with an unchanged income distribution. The need to increase growth rate in these countries does not imply that growth should take priority over policies of redistribution; quite the contrary. Since these countries are extremely unlikely to achieve and sustain the impressive growth rates of China and Vietnam, rapid poverty reduction requires that growth be pro-poor in the strict since of a disproportionate rise in the income share of the poor.

However, few countries are likely to sustain the extraordinary growth rates of China and Vietnam. The Bangladesh case represents the outcome that can be anticipated, even hoped for, by most developing countries: moderately strong growth of GDP, with a modest increase in inequality. Even this modest increase substantially reduced poverty reduction. Distribution neutral growth in Bangladesh would have brought another ten percentage point decline in the headcount ratio.

The most important fiscal instrument for raising growth rates is public investment, followed closely by countercyclical policies. The former raises the potential growth rate, and the latter keeps the economy close to that path. Believers in orthodox macro policies discourage public investment either because of ideological judgements about the appropriate role of the public sector, or for its impact on the fiscal deficit. It can be noted that in only one of the case study countries (Mongolia) was the fiscal deficit so large as to require its reduction to be a policy priority The other five countries satisfied the so-called golden rule of fiscal policy that if governments cover current expenditures by current revenues, public investment can be responsibility financed by borrowing or through development assistance. Indonesia, operating at the time of this report under strict deficit conditionality by external lenders, had the strongest fiscal position of any of the seven countries in terms of the current account surplus. By rational

economic assessment, this fiscal performance would be the basis for expansionary policies to raise the country's growth rate.

A glance down Table1 shows that in none of the countries should inflationary pressure be a cause of concern. In no country was the rate of inflation consistently in double digits in the late 1990s and early 2000s. Cambodia, China, Mongolia and Vietnam experienced deflation or near-deflation, a potential problem that could be benignly overcome through fiscal expansion. To constrain fiscal policy by inflations targets in these countries would be to fight last century's defeated villain.

This report does not conclude that in all cases of slow growth a policy of fiscal expansion is appropriate, even in the absence of inflationary pressure. If a government labours under a large internal or external debt, and deficits are financed through borrowing domestically or externally, the result can generate an unsustainable fiscal position; some argue that this is the situation in Indonesia. However, when GDP growth is lower than the target set by policy makers, an expansionary and countercyclical fiscal policy should be pursued unless there is compelling empirical evidence that it would be counter-productive. It follows that deficits should be judged pragmatically, rather than on the basis of arbitrary targets or ones set by *a priori* argument.

With regard to inflationary pressures constraining fiscal policy, there is noevidence over the last twenty years for any of the seven countries that dysfunctionally high price increases have resulted from excess aggregate demand.[12] High and hyper-inflation episodes were associated with specific institutional and political factors: 1) severe declines in public revenue associated with the transition from central planning to market regulation (Vietnam and Mongolia); 2) collapse of the nominal exchange rate during the Asian financial crisis (Indonesia); and 3) civil war and destruction of state institutions (Cambodia).

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[12] To find an annual rate of inflation in excess of fifteen percent one must go back to 1978 for Bangladesh 1980 for Indonesia other than 1998-1999, and 1975 for Nepal (World Bank, *World Development Indicators 2002*, CD-ROM).

Table 2 presents a summary of the major fiscal policy issues by country. The columns of the tables correspond to the division of the following section that synthesises the findings of the seven country reports.

Table 1: Performance of Key Macroeconomic Indicators by Country, 1990s and Early 2000s

Country	**Poverty reduction**[a]	**Inequality (Gini)**	**Growth Rate per capita**	**Inflation**	**Fiscal Deficit**[b]
Bangladesh	Fell, 50 to 40%	Rose, .32 to .38 (urban) .26 to .30 (rural)	3%	6%	4 to 5%
Cambodia	Increased or did not fall	Increased or did not fall	Not clear[c]	1990s, 5%; 2000-2001, negative	About 7%
China	Fell, 43 to 25%	Rose	7%	High during 1993-97; near zero 1998-2002	About 2.5%
Indonesia	Fell, 15 to 11%, 1990-96, Rose, 1996-00[d]	National, unchanged at about .33; sharp rise in Jakarta	2%[e]	1990-97, <10%; 1998-99, >40%; 2000-02, <10%	1 to 2%
Mongolia	Rose, to about 50%	Rose, .31 to .35, 1995-98	1990-95, -4%; 1996-02, 1%	1991-97, >100%; 1998-02, <10%	7 to 9%
Nepal	Rose, 40 to 50%, 1989-96[f]	Rose, 1989-96[g]	2%	About 10% in 1990s; 3% 2000-02	4%
Vietnam	Fell, 58 to 37%, 1993-98	Rose, .33 to .35, 1993-98	5%	Continuous decline, 1996-2002 towards zero	4%

Notes:

[a] Headcount ratio, national.

[b] Percentage of GDP.

[c] In constant local currency units, in the 3 to 3.5 range; negative in constant US dollars.

[d] Long-term decline 1976-1996, 40 to 11%; if different measures are linked, rose to 35% in mid-1998, then fell to near 1996 level in 2000.

[e] GDP per capita fell by about 20 percent during 1997-98.

[f] 1989 is a WB and UNDP estimate; 1996 is from the National Living Standards Survey.

[g] As measured by the income share of the top decile.

Table 1 (continued)

Country	**Macro policies**	**Expenditures**	**Revenues**	**Other**
Mongolia	Low growth; fiscal policy passive;	Public investment required for poverty reduction;	Increased revenue required for pro-poor policies, but no priorities or plan; improved tax administration; analysis of tax incidence required; potential to raise non-tax revenue;	High external debt, but further debt could be used for high return public investments; large fiscal deficit; limited scope for domestic borrowing to finance public investment;
Nepal	Slow growth, passive fiscal policy, exacerbated by donor & lender pressures for low deficit;	Insufficient gov't investment; insufficient spending on economic sectors;	Revenue collection weak;	Aid dependency; limited fiscal space; quick sale of SOEs unwise; donor & lender funds volatile; political constraints on planned fiscal decentralisation; lack of fiscal autonomy from donors & lenders, preventing domestic financing of deficits;
Vietnam	Rapid growth; fiscal policy strongly growth-enhancing & counter-cyclical;	Generally pro-poor, targeted programmes could be replaced by universal ones; military & security spending needs review; social subsidies pro-poor;	Satisfactory revenue performance, revenue incidence could be more pro-poor	Potential problem of recapitalising financial sector; increasing inequality of wealth & income; inflexible link between current & capital spending;

Table 2: Summary of Policies Issues by Country

Country	**Macro policies**	**Expenditures**	**Revenues**	**Other**
Bangladesh	Moderate growth; fiscal policy counter-cyclical, moderately growth enhancing	Decline in productive public investment, increase for social sectors; education spending pro-poor because weighted to primary education; spending on child health pro-poor; but per capita	Revenue levels low & income inelastic;	Declining ODA created expenditure constraint; potential problem of size of fiscal deficit; shift in public spending from investment to social services; effective pro-poor growth requires improved revenue

		social expenditure low;		performance
Cambodia	Slow growth; fiscal policy passive;	Expenditure switching to social sectors results in agriculture receiving little public funding; pro-poor expenditure constrained by poor implementation;	Only modest increases in revenue are possible; unutilised investment resources available from overseas ForEx accounts;	Aid dependency, with fiscal policy externally constrained; no policy link between fiscal policy & poverty reduction; shift in public spending from investment to social services; growth prospects uncertain; reduction of civil service unwise;
China	Rapid growth; fiscal policy strongly pro-growth & counter-cyclical;	Education expenditure should be redirected among provinces; expenditure needed for urban welfare systems & to reduce environmental degradation;	Restructuring of revenue sources needed, to simply & increase revenue;	Major fiscal problem is deflation; process of fiscal decentralisation; potentially large cost of recapitalisation of banking system; careful sequencing of ‘reforms’ needed to protect the poor;
Indonesia	Low growth; fiscal policy pro-cyclical & too contractionary; prohibition on domestic funding of deficit; output-depressing interest rates;	Declining & insufficient gov’t investment; public investment would crowd-in private investment;	Increased revenue needed to support pro-poor growth	Pro-poor policies undermined by bank & enterprise bailout; excessive emphasis on export growth

III. Fiscal Issues for Pro-poor Growth

A. Macroeconomic Policies and Investment-led Growth

The necessary elements in a pro-poor macro policy are a strong public investment programme and countercyclical policies. The case studies show that the countries whose macro frameworks included these two principles enjoyed strong and stable growth. On the other hand, governments that sought to achieve deficit targets not directly related to growth or poverty objectives suffered from stagnation in output.

Every government must maintain a sustainable fiscal policy. This includes a deficit that is manageable in the short term, and that the associated public debt it creates is serviceable. However, the case studies show that 'sound fiscal policy' involves much more than this. The economic function of government is not merely to maintain a stable macro environment; its primary responsibility to its citizens is to foster the general welfare. A deficit target should not be set that undermines a government's ability to achieve the latter. Indeed, a specific target, whatever its level, reduces a government's ability to manage the economy by rendering fiscal policy essentially endogenous.[13] In general, governments should manage deficits to be consistent with sustainable growth, one aspect of which is macroeconomic stability. Our case studies suggest that artificially low inflation targets and concern about 'crowding out' private investment seriously undermine growth and, therefore, poverty reduction. The first, inflation, does not appear to be a problem in any of the countries; quite the contrary, the relevant threat would appear to be deflation. In Indonesia

[13] If t is the tax rate, a is the propensity to consume, and using the standard notation for national income (Y), consumption (C), private investment (I), government expenditure (G), exports (X) and imports (M), we can write:

$$Y = C + I + G + (X-M)$$

$$Y = a(1-t)Y + I + G + (X-M)$$

The deficit target can be specified as follows, where b is greater than unity:

$$G = b(tY)$$

Therefore,

$$Y = [I + (X-M)]/[1 - a + t(a - b)]$$

inflation targeting has made a substantial contribution to the meagre growth rates since the late 1990s, while China and Vietnam have enjoyed high rates and inflation falling towards zero.

Liberating policy from a deficit target makes fiscal space for public investment. Again, China and Vietnam are outstanding examples of robust public investment, which has facilitated private investment, both domestic and foreign. While in both countries the public sector accounts for a considerable share of output (more in Vietnam than in China), private investment has grown more rapidly than public. In contrast, countries that have limited the investment role of the public sector, Cambodia, Indonesia, Mongolia, and Nepal, have experience an inferior investment performance by the private sector.

Indonesia is a particularly clear case in which low public investment has been associated with a stagnant private sector performance. In this case, pressure to keep the deficit becomes particularly contractionary in the context of bank 'recapitalisation'. An open-ended commitment to covering the losses of bank creditors has resulted in a process of bank recapitalisation that is profoundly anti-poor, involving two regressive redistributions: a) from general revenue to wealthy creditors, and b) within the government budget from development and social expenditure to those same creditors. If any of the fiscal positions reviewed in the case studies could be described as 'out of control' and 'mismanaged' it was that in Indonesia. As important as the regressive redistribution is, perhaps even more anti-poor in the medium and long term is the contraction of fiscal space that undermines countercyclical policies and public investment. As a portion of national income, the latter fell to half what it had been during the Sukarno period. The major lesson to learn is that governments must be extremely wary of financial liberalisation, which was the basic cause of large external debts held by banks; and, should an Indonesian-type financial crisis develop, government 'bail-out' commitments should be limited, not open-ended.

Demand management by fiscal is reduced to the tax rate (the denominator is the 'balanced budget multiplier').

The case studies show that increasing expenditure on social sectors is almost always pro-poor. However, pro-poor expenditure switching is more complicated than a relative increase in allocations to social sectors. In Bangladesh, Cambodia, and Nepal, this expenditure switching was associated, in varying degrees, with a fall in public expenditure on economic sectors. As a result, the expenditure switching may have reduced the long-term growth potential of these countries. The opposite case is Vietnam, where during the transitional period, 1985-2000, expenditure on social services declined, and 'user fees', formal or informal, restricted access to basic health and education. At the same time, public investment, targeted to key industries and economic activities increased dramatically (with much of the increase from external sources. During this decade, policy has shifted, as shown in the government's commitment to provide again free access to health and education. It is open to debate whether the rather draconian approach to social expenditure in the 1990s was a necessary part of the country's performance on economic growth and poverty reduction. Having overseen that impressive performance, the government now seeks to close its 'social deficits'.

The considerable success of China and Vietnam in managing the transition from central planning to market regulation is in contrast to the low growth of Mongolia. In part the contrast can be explained by the structural position of the countries prior to the collapse of the Soviet Union. Mongolia was tightly integrated into Soviet economic and political structures, which was not the case for Vietnam, though it received substantial Soviet assistance. China had substantially eliminated its dependence on the Soviet Union thirty years ago. The implications for fiscal management in Mongolia of the end of the Soviet period have been profound and debilitating, the virtual collapse of its revenue sources. Even in such unfavourable circumstances, the case study suggests that a more active and pro-poor fiscal policy is possible and sustainable. In an environment in which fundamental change must occur to institutionalise market processes, it is unrealistic in the extreme to think that achieving macroeconomic stability, in the sense of low inflation and low fiscal deficits, will in itself foster private

investment, domestic or foreign. The lesson from China and Vietnam is that successful transitions that generate private sector confidence require a purposeful government with an active fiscal policy whose key element is public investment.

B. Private and Public Investment

Over the last two decades there was been a tendency in neoclassical development economics to presume that 'crowding out'.[14] is the typical relationship between public and private investment. Analytically, 'crowding out' becomes a significant possibility when an economy is near full employment. When there are unutilised resources, there is economic space for an increase in all types of expenditure, both public and private. However, even if 'crowding out' occurs under these circumstances, it is unlikely to be complete[15]. As a consequence, public investment would be growth-inducing both in its demand and capacity effects, unless the return on the marginal private component were sufficiently higher than on the public component such that the growth impact were negative. This can be shown formally using the simple Harrod-Domar model, where y is the rate of growth, v is the incremental capital-output ratio, and I is the share of investment in output. Let the subscripts *pr* and *pu* be private and public investment, respectively. Without public investment, the warranted (potential) rate of growth of the economy is:

$$y_o = [v_{pr}][i_{pr}]$$

Let the 'crowding out' ratio be α (the faction by which public investment reduces private investment). Then, the new growth rate with public investment is:

$$y_1 = [v_{pr}][i_{pr} - \alpha i_{pu}] + [v_{pu}][i_{pu}]$$

Subtracting y_1 from y_o, one gets:

$$y_o - y_1 = [v_{pu}][i_{pu}] - [\alpha i_{pu}]$$

[14] The crowding out phenomenon applies to all expenditure, but here we consider only the case of investment.

[15] Formally, this implies that we expect the elasticity of private investment with respect to government expenditure of any type to be typically less than minus one.

$= i_{pu}[v_{pu} - \alpha v_{pu}]$

Crowding out will reduce the rate of growth if an only if, $v_{pu} < \alpha v_{pu}$. If the capital-output ratio for public investment is no larger than for private investment, public investment never reduces the growth rate, no matter what the value of a, assuming its upper limit to be unity ('total crowding out', one hundred percent); if crowding out is total, the growth rate falls only if public investments are more capital-using than private ones. Thus, public investment having a negative impact on the capacity-creating source of growth occurs only under the very restrictive conditions that crowding out is total and private investments use less capital per unit of output. The former is unlikely and the latter can be avoided by public choice of investment projects. Thus, theory suggests that crowding out is unlikely to have a negative impact on growth, which is the conclusion in all the case studies.

The two countries with the strongest public investment programmes, China and Vietnam, also had the highest rates of growth. Both countries attached large inflows of foreign direct investment, suggesting that, at least, major public investments did not discourage such inflows and may have facilitated them. The other five countries had much smaller public investment programmes, and slower growth than China and Vietnam. Though 'crowding out' of private investment by public expenditure has been alleged to be the case, for none of the countries is there empirical evidence to support this view. In the case of Indonesia, the case study report provides statistical evidence of the opposite in recent years, 'crowding in' of private investment by public investment. This finding is consistent with performance during the Suharto regime, when economic growth was a vigorous seven percent per annum over more than twenty years, and both private and public investment were high. Since the Asia crisis, private investment has been remained consistently low, as public investment has been cut under pressure to reduce the fiscal deficit. As noted in the report, this pressure arises primarily from what was initially an open-ended commitment by the government to compensate the creditors of private banks. Thus, in addition to

being regressive in terms of income distribution, bank recapitalisation has undermined growth by its squeeze on public investment.

'Crowding out' is also unlikely in Bangladesh, Cambodia and Nepal, where public investment has shifted from economic sectors to social sectors. However, the case studies suggest, especially for Cambodia and Nepal, that this shift may have negative consequences for longer term growth. In the case of Mongolia, the public investment programme is so small and the domestic private sector so weak, that 'crowding out' is not credible.

Table 3: Relationship between Public and Private Investment

Country	Public Investment Policy	Interaction between Public & Private Investment	Is public investment pro-poor?
Bangladesh	**Weak public investment programme**; public investment has been a low & relatively constant proportion of GDP; shift in expenditure from economic to social sectors;	Empirical evidence indicates only partial 'crowding-out', so that public investment has a net capacity increasing effect	**Yes**, with shift to social sectors
Cambodia	**Weak public investment programme**; strongly dependent on external assistance, & conditionalities constrain borrowing; PIP not integrated into growth strategy & budgets; shift from economic to social sectors;	No evidence of 'crowding out'; more likely to result from current expenditure than capital expenditure; method of financing deficits can negate the 'crowding' effect;	Probably **no**, evidence lacking; weak programme makes pro-poor impact unlikely; shift to social expenditures potentially pro-poor in short run
China	**Strong public investment programme** in infrastructure & social sectors; public ownership of large part of productive sectors;	No evidence of 'crowding out' effect of public investment, but there may be strong 'crowding out' of private domestic investment by FDI *via* demand for skilled labour;	No conclusion can be drawn, except for the growth effect; emphasis on large projects;
Indonesia	**Weak & contracting public investment programme,** much less than under the Sukarno regime; constrained by tight monetary policy & fiscal pressure from bank 'bailout'	Empirical evidence that public investment 'crowds-in' private investment; substantial excess reverses in banking system indicates weak private motivation to invest;	**No**, decline in expenditure has fatally weakened the any pro-poor impact
Mongolia	**Weak public investment programme** that expects public investment to be	Given low growth & low private investment, 'crowding out' effect is	**No**, too weak to have any pro-poor effect

	led by private investment;	not credible;	
Nepal	**Weak public investment programme;** shift in expenditure from economic to social sectors;	Not evidence of 'crowding out' of private by public investment	**Yes,** in principle**, no** in practice, because implementation very weak
Vietnam	**Strong public investment programme** in infra-structure & social sectors; public ownership of large part of productive sectors;	Growing domestic private investment & large FDI inflows suggest complementarity	**Yes**, for the MOLISA 'backward regions' programmes & social expenditures

Notes:
PIP – Public Investment Programme (the formal document)

C. Pro-poor fiscal instruments

(1) VAT neutrality

Within applied public economics, there has in recent times emerged a consensus that indirect tax reform involves as a necessary first step, replacing taxes on international trade with taxes on domestic goods and services in a manner that leaves the overall Tax-GDP ratio unchanged The centre piece of such a reform has been the introduction of a Value added tax (VAT) that is revenue neutral or revenue enhancing. The argument for this reform is clear: VAT eliminates cross border distortions on consumer and producer prices, and prevents tax cascading. The scope and range of implementation of this reform has been breathtaking enough to legitimately call the proposition VAT reform argument the "doctrine" of a revenue neutral VAT.

Stiglitz and colleagues have recently been questioning this proposition on theoretical grounds. (Emran and Stiglitz 2002). They argue that "there is an important structural feature of a developing country that militates against the desirability of a VAT: the existence of a large informal sector that escapes the VAT net. (2002; page 1) This implies (1) that a VAT may create intersectoral and welfare reducing distortions between formal and informal sectors even as the revenue neutral reduction in trade taxes reduces cross border welfare distortions. (2) when (as is often the case with real world tax reform recommendations by the IMF) proposed tax reforms are selective and not comprehensive, there is the additional possibility that the intended revenue neutrality of the VAT substitution may not come about. In such a case there will either be a shortfall in aggregate tax collection or the tax burden caused by VAT broadening will be greater than anticipated (i.e. the welfare losses incurred to generate revenue neutrality will be greater than anticipated *ex ante*). The root of this argument lies in the establishment of the proposition that it is feasible to impose and collect indirect tax on the commodity set bearing the lowest indirect tax on consumption. While this is a truism when there exists just a formal sector, with an informal; sector the "..best one can hope is to select the commodity that enjoys the lowest indirect tax

burden among the subset of formal commodities as a candidate for VAT increase." (2002 page 4) In such a situation, the authors theoretically establish that there are plausible sufficient conditions for a welfare drop from a reduction in import tariff with a revenue neutral VAT (implying, therefore a revenue decline if welfare neutrality is a binding constraint) .

Nepal provides an interesting empirical case that provides empirical and policy validation to the above argument. In the UNDP commissioned report (Roy 2003) it was found that a concerted effort to implement a VAT and reduce import duties as part of an overall economic reform initiative failed principally because the VAT effort did not prove to be revenue neutral. In Nepal, VAT was introduced in 1997, following a budgetary resolution to do so in 1992, as part of conditionality compliance. Enthusiastic and generous donor support for VAT design and implementation was made available during the period,. Donor doctrine favoured VAT introduction and those who were pessimistic about its success, principally due to the political economy of the informal sector in Nepal, found their opinions disregarded. A leading Nepalese tax economist commented "Only the positive aspects of VAT were discussed and publicised. The negative aspects were not taken into consideration. People who expressed their doubt were told that smuggling would automatically be uprooted, revenue leakages would automatically be controlled and revenue collection would increase so much that foreign aid would not be required" (Thapa 2001, page 43)

The consequences of this doctrinaire hard sell were highly negative for Nepal's revenue structure. First the VAT was not revenue neutral. Revenue shortfall (actual less estimated revenues) went from less than 2 per cent in 1992 93 to 11 per cent in 1997-98. Since then revenue shortfalls have hovered between five and seven per cent (Roy 2003). While correlation does not automatically imply causation, it is clear that there was policy failure. Thapa (2001) in fact points out that the ratio of VAT to total tax revenue (around 30 per cent each year since 1996-97) is consistently lower than the total share of the four major taxes it replaced in that year.

(2) Domestic resource mobilisation

Concessional assistance can complement domestic resources for development – it can never substitute for it, or even act as the principal source of development assistance in the long term. This fact has long been recognised in development circles and several conditionality based strategic documents have emphasised the need to enhance tax GDP ratios as a necessary condition for sustainable resource mobilisation.

Domestic borrowing is a second source of public resource mobilisation. It represents a transfer from the domestic private sector to the domestic public sector and hence does not directly increase a country's liabilities to the rest of the

world. It can also increase the propensity to save to the extent that such borrowing reduces domestic consumption. It can, however, crowd out private investment and have negative distributional implications, depending on the country context, the fiscal situation and precisely how the borrowing is done. Hence it is important to assess the net benefits of domestic borrowing in determining its optimal magnitude

It has historically been the case that domestic borrowing for public investment has been an important source of resource mobilisation for growth and development. in many developing and indeed industrial countries. While domestic borrowing to finance government consumption is widely recognised as undesirable, domestic borrowing for appropriate public investments with demonstrable returns in terms of socio-economic and human development are regarded as perfectly acceptable in moist developed countries. The 'rules' for fiscal deficits advocated by British Chancellor Gordon Brown allow for borrowing for critical public investments.

However, the same freedom for manoeuvre is often not available to developing countries as a direct consequence of policy conditionalities that place severe curbs on domestic borrowing without reference to whether such borrowing finances consumption (as it does in India) or investment. Research conducted under the auspices of the UNDP Asia Pacific programme indicates that there is a case for re examining the doctrinaire assertion that domestic borrowing is always a bad thing.

The cases of Cambodia, and Indonesia on the one hand, and Vietnam on the other illustrate the above point. In Cambodia the bulk of resources accruing to government for its consumption expenditure are generated through domestic revenues. In recent years Cambodian current revenues have slightly exceeded current expenditures, providing a small surplus for investment. (Roy 2003 b) However, the Cambodian revenue GDP ratio is lower than that in many other Asian countries at comparable levels of development (IMF 2001) Most long term Cambodian strategic documents, including the conditionality-consistent Poverty Reduction Strategy Paper do not project this ratio to increase except very modestly in the medium term. Roy (2003)b reviews the policy arguments for such modesty and concludes that "…the conservatism in revenue forecasting is well justified' (2003b; page 9)

In these circumstances it would be natural to look at resource mobilisation through domestic borrowing for public investment. However, Cambodia is constrained by severe conditionalities which prohibit government recourse to domestic borrowing. In Cambodia, domestic savings tend to be insufficiently monetised due to a troubled political history and lack of confidence in the private banking system. This is often used as a justification for not allowing immature private financial institutions to lend to government.

However, in India the creation of a primary market for sovereign paper has been an important spur, historically, to savings monetisation. Such sovereign paper substitutes for forms of saving that do not permit its realisation for productive investment (like gold and cash entrusted to informal agents). In Cambodia estimates of unrealised savings touch five per cent of GDP (Roy 2003 b). If realised for productive investment this would be a substantial boost to public resource mobilisation efforts; the PRSP based conditionality mechanism could be used to direct such resources to productive ends.

The above scenario is in fact particularly ironic with respect to the existing situation with bank credit. In 2002 deposit liabilities of the commercial banks have been around nine per cent of GDP while total lending (almost entirely to the private sector) accounts for less than six per cent of GDP Thus, even with realised savings, banks are unable to lend at prevailing rates of interest., In total therefore close to ten per cent of Cambodian GDP is idle from a development point of view. The surplus resources in the banking sector are in fact placed by the Cambodian central bank in the inter bank call money markets in Singapore – a perfectly understandable banking decision even though its sub-optimality from a development banking perspective is quite apparent.

This realisation problem, highlighted in the Cambodian case indicates that short term fiscal analyses about debt sustainability based on simplistic stress tests or tests for cointegration of debt time series may overlook serious problems with realisation of productive resources for development, as such structural factors would be *ceteris paribus* variables in such analyses. It is imperative that long term strategic thinking on such issues be encouraged and a policy platform found top encourage such thinking in macroeconomic documents like PRSPs, so that an important potential source of development finance is not overlooked by exclusively relying on short term doctrinal evaluations of a countries domestic debt "sustainability"

Vietnam illustrates the opposite case. Several morose and dismal judgements have been made about Vietnam's fiscal position since the comparatively recent involvement of the Bretton Woods institutions in that country. However, Vietnam has enjoyed impressive growth rates and a well maintained fisc even while steadily increasing the share of its resources devoted to public investment; Vietnam has the best track record among the case study countries for poverty alleviation. The case study report finds clear evidence steady and publicly financed investments in infrastructure health and education have been instrumental in securing this sustained and impressive improvement in national economic and human development (Roy 2003c).

Of course, it is true that domestic debt financed resource mobilisation must be used for appropriate purposes. Judicious pro-poor Public investment may not always be the end use for such resources. The Indonesian case study provides one such example and presents a rather different aspect of the resource mobilisation

issue. Rao and Khattry (2003) indicate a steady transfer of public resources to the private sector in that country with the Indonesian government required to pay interest and principal on public bonds issued to refinance private bank re-capitalisation. In effect in Indonesia the public exchequer has had to bear the cost of this private burden, creating a reverse flow of resources from the public to the private sector, to the tune of 4.4 per cent of GDP in 2001. In conjunction with a tight monetary policy resulting in high interest rates, the Indonesia report argues that "the IMF has forced the government into a debt trap (by) transferring private debt to the public sector" (2003; page 49). As a consequence, though Indonesia has a high primary fiscal surplus due to expenditure contractions and some revenue growth, this surplus has not been used for pro poor public investment; it has instead been used to amortise bad private sector debt.

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Figure 1

Relationship between Inequality and Per Capita Income
for Constant Levels of Headcount Poverty

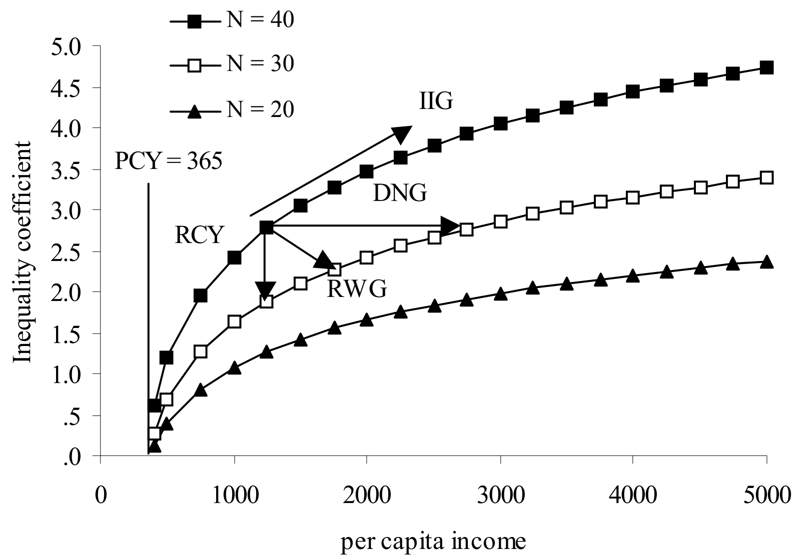

Figure 2

Poverty Reduction and GDP Growth
for Degrees of Inequality