Fiscal choices and poverty reduction

Reconsidering the *composition* of revenue and spending from the perspective of poverty reduction
Outline of the Presentation

◆ A Framework

◆ Key questions in assessing PRSPs
  - expenditure and revenue policies
  - public financial management
  - performance and results
Step 1
Assessing poverty outcomes and causal factors

Step 2
Determine rationale for government intervention

Market failures:
- public goods
- externalities
- monopolies

Unequal distribution of:
- income and/or
- access to key services

Step 3
Decide on mode of intervention

- Regulation
- Tax
- Public Finance & Private Provision
- Public Finance & Provision

Step 4
Decide on Mode of Intervention:
- Cost effectiveness analysis
- Multi-criteria analysis
- Social cost-benefit analysis

Step 5
Assess the efficiency and equity of public spending
Key questions in assessing PRSPs

1. Are expenditure allocations, as well as revenue policies, strategically linked to poverty reduction objectives and targets?

2. Are proposed plans for fiscal management – decision making processes, institutions, and systems – consistent with and capable of delivering the PRSP’s stated objectives?

3. Is there transparent monitoring and accounting of the flow of public funds and the delivery of public services?
1. Linking revenue and expenditure policies to poverty reduction objectives

(i) Collecting sufficient revenue, but also considering who pays

(ii) Improving the quality of expenditure analysis, and allocative efficiency of expenditures
(i) Taxation instruments and reform

- **Primary objective should be to raise revenue as efficiently and equitably as possible**

- **Tax reform**
  - increase transparency and certainty
  - problem of eroded tax bases -- esp. conflict countries
  - need to deal with evasion
  - institutional capacity is needed
  - certain reforms will reduce revenue in the short term
    - eg elimination of export tax and excess wage tax

- Significant progress has been made -- especially in Armenia, Georgia and Moldova
(ii) Revenue Composition

Tax systems can be progressive, and it is important to consider the distributive impact of alternative financing instruments (including cost recovery)

Arguments in favor of cost recovery:

i) Allocative efficiency – avoid ‘overconsumption’
ii) Examine demand elasticities and consumption patterns

Arguments against:

i) Lack of capital markets and of insurance markets
ii) Participatory surveys suggest that fees inhibit access

Conclusions about distributive effects depend on
- assumptions about burden shifting (who pays); and
- whether a general or partial equilibrium approach
(i) Scrutiny of major spending programs (at least)

Both quantitative and qualitative data is needed:

- Actual budget out-turns, not only the plan
- Information from donors by sector

Obvious links to public financial management and performance results (below).

There are some well-established tools available to improve the allocation of government spending (see section 3 of sourcebook public spending chapter).
Spending prioritization involves tradeoffs

This has inter and intra-sectoral dimensions:

- Direct vs indirect (short vs long term) poverty impact
  > targeted nutrition vs secondary schooling

- Growth versus redistribution
  > roads to market or social assistance
  > Under-investment in infrastructure risks future growth -- eg Azerbaijan, <2% GDP

- Capital vs O & M vs salary. Within sectors, somewhat easier than between sectors
Tools for Allocative Efficiency

1. Cost effectiveness analysis (eg QALYS in health)
   - No attempt to value benefits or externalities
   - The narrower the goal, the narrower the range of comparable programs. Diverse forms of benefits cannot be compared

2. Multi criteria analysis
   - Less information intensive; can be participatory
   - But scoring may be arbitrary, possible overlap

3. Social cost benefit analysis
Social cost benefit analysis -- comparing rates of return

• Need to value the benefit
  – willingness to pay, or some surrogate (e.g., rate of return to education)
  – These can be given distributional weights
  – Need to incorporate externalities and account for possible substitution effects -- both are difficult.

• Accounting for costs
  – financial cost of borrowing
  – distortionary costs of raising domestic taxes
2. How do proposed plans for fiscal management match with the PRSP’s stated objectives?

(i) Medium Term Orientation

• Basic accounting & financial disclosure practices
• More generally, need to improve
  – awareness of costs and available resources, especially the recurrent costs of capital spending;
  – forecasting ability; and
  – the medium-term focus of decisions within a forward looking macro framework.

(ii) Public financial management

• Timely budget preparation systems
• Predictability -- realistic revenue forecasts to avoid arrears and credit rationing
• Importance of openness and transparency
• Extra-budgetary Funds -- not a special case
3. Is there transparent monitoring and accounting of the flow of public funds and the delivery of public services?

- Functioning treasuries, with full coverage of government operations to report on execution,
  - including subnational and extra-budgetary activities

- Additional measures (e.g., tracking studies)

- Decentralisation may be an option to increase accountability and responsiveness, BUT…. 