

# The Inclusive Growth Agenda

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## A case for Emerging Mega Economies

**Rathin Roy\* and Honey Karun**

### **Abstract**

Emerging Mega Economies (EME) globally face a twin challenge when it comes to use of fiscal policy instruments. The first challenge is long term and that is for fiscal policy to deploy its allocation, distribution and growth enhancement functions to secure inclusive growth consistent with macroeconomic stability objectives. The second is to protect inclusive growth from exogenous shocks by deploying the stabilisation function. The recent global economic crises of 2008 provide us with an opportunity to examine these issues from a policy perspective. Our analysis of macro fiscal and sectoral trends on ‘merit’ goods like health and education shows that while EME display considerable convergence on growth, they do not show any convergence on revenue policy, the size of government in GDP and policies on public spending on merit goods like health and education. The EME have deployed countercyclical fiscal policies that are tailored to individual circumstances, and have been mindful of prudential limitations thus alleviating the fear that persistence with such policies would jeopardize fiscal prudence. Even in the case of India, which has been going through some recent macroeconomic difficulties, it is supply side constraints and balance of payment difficulties that have caused problems in macroeconomic management rather than the inability to speedily tone down countercyclical fiscal policies. As far as inclusion goes, this paper does not find any dramatic, first-order link between performance in individual measures of inclusion and the conduct of fiscal policy.

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The opinions expressed in the paper are those of the author and do not necessarily reflect the views of the Institute.

## A. Introduction and Some Analytical Considerations

The sustainability of policies to create fiscal space is a function of what the fiscal space is used for. The balance of emphasis placed on the stabilization, allocation, and distribution and growth functions of fiscal policy would differ according to the timeframe of the analytical framework and the context of the political economy (Roy, Heuty, and Letouze 2009). Finding sustainable fiscal space for inclusive growth therefore involves asking what the purpose of public spending is, the timeframe for its implementation, and the context within which it is implemented.

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

An important question to consider, in assessing whether fiscal space exists for inclusive growth is to examine the extent to which a country's fiscal policies are generally prudent and whether or not there is room to increase fiscal space through expansionary fiscal policies. In this context, it is worth repeating that one of the requirements for inclusive growth is that there must be steady and stable growth. Inclusion, as an objective of fiscal policy is expected to complement, not compromise, the growth potential of an economy. Hence, it is important to examine whether or not there exists fiscal space for inclusive growth in terms of a country's inter-temporal fiscal profile. This involves looking at the potential for securing incremental fiscal space to run such expansionary fiscal policies that may be necessary to improve on inclusion; it also means that the size of the G/GDP ratio, whether tax or debt financed, should not increase to an extent, and at a pace, where it crowds out growth-generating private sector activity.

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

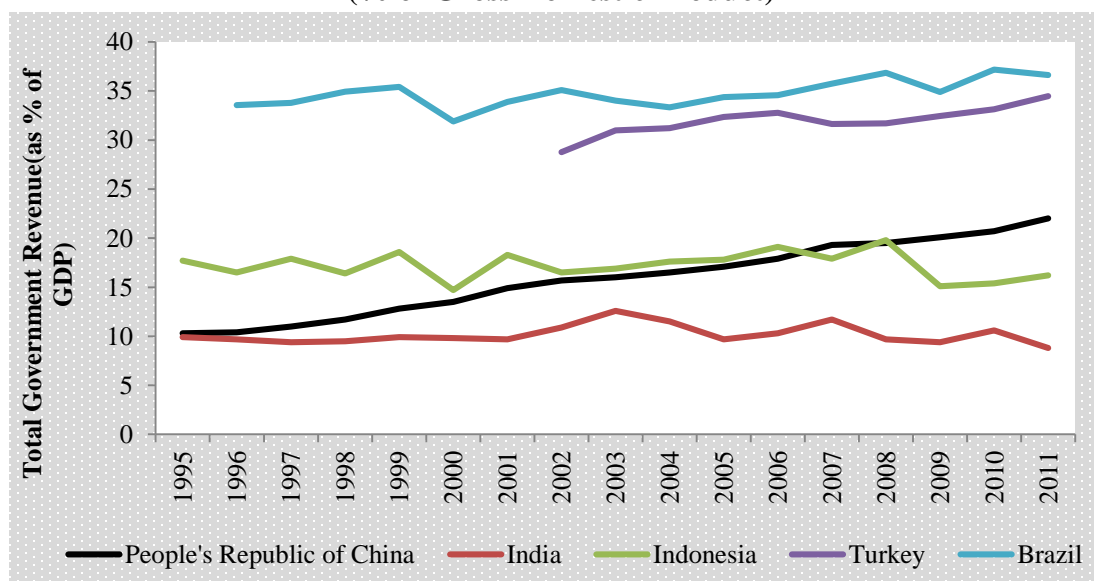
## B. Overview of Fiscal Trends in Emerging Market Economies (EME)

### 1. Fiscal Stance: Revenue and Expenditure Trends

#### a. Revenue Trend

Revenue trends in the EME show no congruence though trends individually are stable. The PRC records a steady rise in its revenue–GDP ratio while India and Indonesia performs poorly on this score with temporary improvements in good years reversed in bad years. (Figure B.1.1) Brazil and Turkey on the other hand, show an impressive steady rise in their revenue-GDP ratio, even in the years of recent global financial crisis. Although the size of GDP in this group varies significantly, yet Brazil and Turkey collect almost two and three times (as a percentage of GDP respectively) the revenue of India and Indonesia.

**Figure B.1.1: Total Government Revenue in Emerging Mega Economies (% of Gross Domestic Product)**



Source: Data for India, Indonesia and People's Republic of China (PRC) is sourced from ADB Country Profiles Database. Data for Turkey and Brazil is sourced from World Economic Outlook, Country Profiles Database (April 2014), IMF.

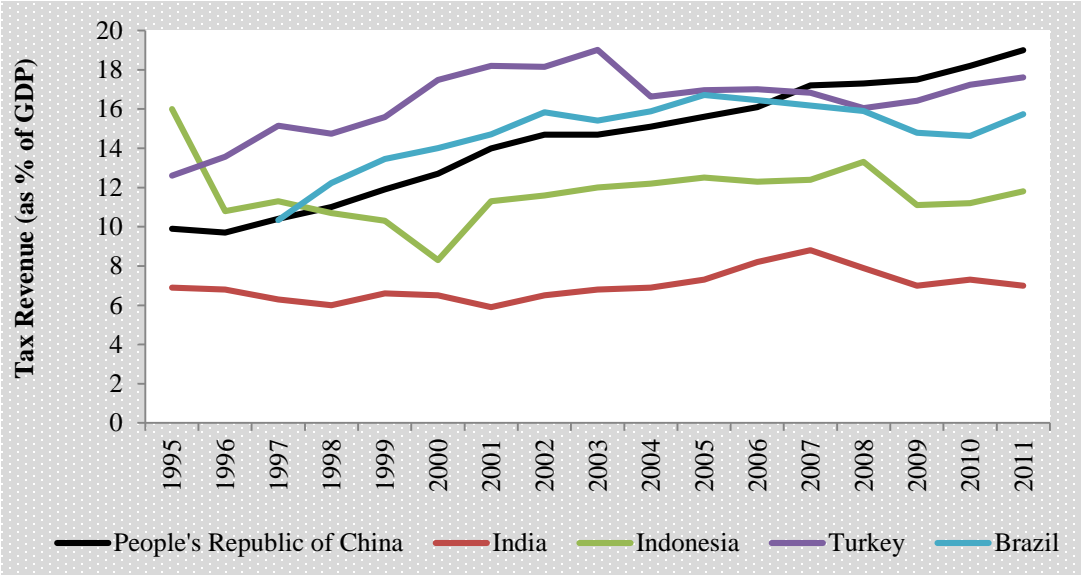
Note: Data refers to central government for India, Indonesia and PRC. Data refers to general government for Turkey and Brazil.

The tax-GDP ratio rises as the level (as opposed to the rate of growth) of GDP increases (Hinrichs 1966). It is not, then, surprising that tax-GDP ratio in China is rising, since; its GDP level has been rising because of its sustained double digit growth. This has not been the case for other emerging economies. Brazil and Turkey are high middle income countries and, therefore, their revenue-GDP ratio is higher than Indonesia and India, though, they exhibit volatile trends. India, has exhibited a consistently low and stagnant revenue-GDP ratio despite episodes of economic growth. It is widely acknowledged in the literature, that this, in turn, led to a

considerable gap in tax revenue (12th Finance Commission 2004). The tax gap is due to existence of a sizeable underground economy as well as large tax expenditures. In the entire analysis period of 1995-2011, no EME collected tax revenues in excess of 20% of GDP. (Figure B.1.2) India performs poorly with tax collection less than 10% of its GDP. Indonesia observed a sharp decline in its tax collections till 2000. However, Indonesia stabilized its tax revenue ratio to around 12% of GDP in the later years. Brazil has observed a cyclical pattern with steady increase in its ratio till 2005 and a steady decline afterwards. Turkey is the only country in the group which touched 20 % tax revenue (19 % in 2003). However, Turkey has also observed a steady decline in its tax revenue since then.

These trends may have strong macro-fiscal implications for these economies as these economies rely heavily on non-tax revenue receipts. On average, compared with high and middle income economies in other regions, this is indeed a fairly conservative effort particularly for the EME where only the PRC exhibits a steady increase in its ratio.

**Figure B.1.2: Tax Revenue in Emerging Mega Economies  
(% of Gross Domestic Product)**



Source: Data for India, Indonesia and People’s Republic of China (PRC) is sourced from ADB Country Profiles Database. Data for Turkey is sourced from Organisation for Economic Co-operation and Development (OECD), Country Profiles Database. Data for Brazil is sourced from World Development Indicators, World Bank

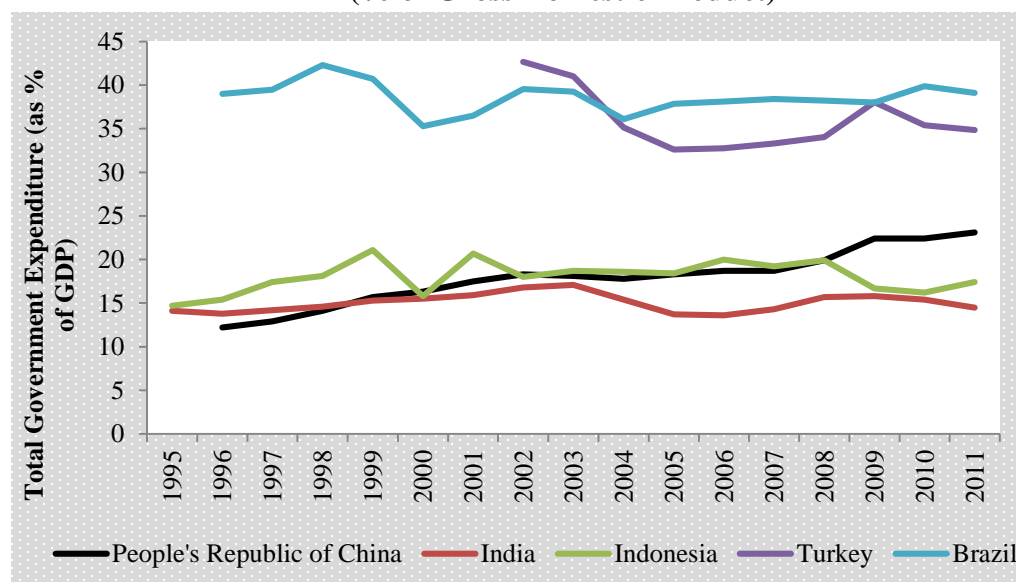
Note: Data refers to central government for India, Indonesia, PRC and Turkey. Data refers to general government for Brazil.

## b. Expenditure Trend

It is clear that the EME as a group does not share much commonality in expenditure trends. Relatively lower income EME like India and Indonesia spend less than higher income EME like Brazil and Turkey. The EME, thus, confirms the general trend of larger outlays on public and merit goods in higher income economies compared to relatively lower income economies.

In addition, both Brazil and Turkey deploy explicit redistribution policies, including social protection policies, to a far great extent than India and Indonesia. Again, this does not seem to be unusual as one would expect higher income economies to deploy a substantial proportion of their public finances in redistributive transfers. It is clear that these EME have in fact embarked on the course of redistributive policies where relatively high levels of income inequality (see Table B.3.2) are sort to be ameliorated through such transfers. The PRC has matched increased revenue–GDP ratios with increases in public spending; the ratio has stayed more or less constant in India and has fallen since 2008 in Indonesia. (Figure B.1.3) Turkey has observed the sharpest decline in its public spending from around 43% of GDP in 2002 to 35 % in 2011. Brazil observed volatility in its public spending during 1995-2003, however, stabilized to around 38% of GDP in the later years.

**Figure B.1.3: Total Government Expenditure in Emerging Mega Economies  
(% of Gross Domestic Product)**



Source: Data for India, Indonesia and People's Republic of China (PRC) is sourced from ADB Country Profiles Database. Data for Turkey and Brazil is sourced from World Economic Outlook, Country Profiles Database (April 2014), IMF.

Note: Data refers to central government for India, Indonesia and PRC. Data refers to general government for Turkey and Brazil.

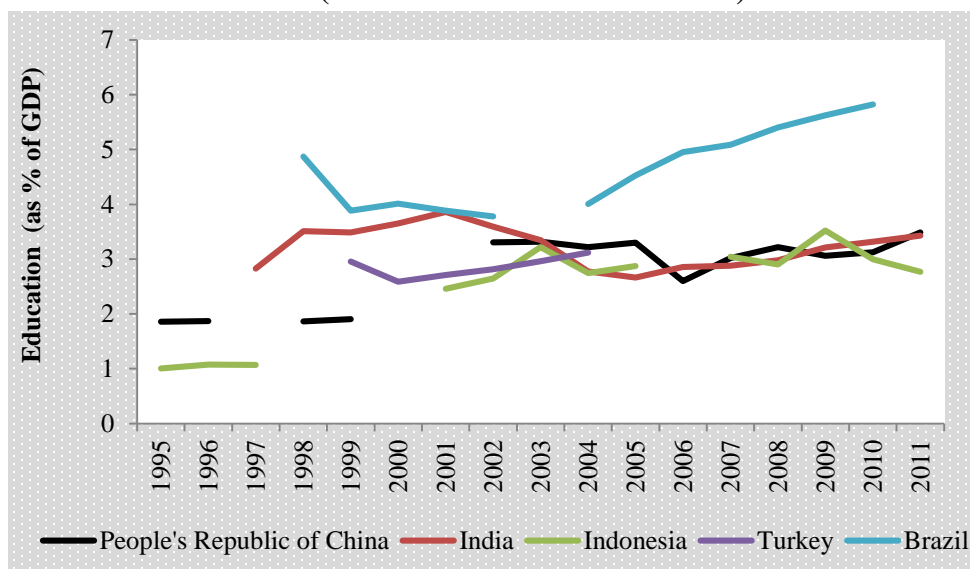
Thus China is an exception amongst the EME. Despite consistently high growth and GDP levels, the government (G)-GDP ratio remains constant; rather China sort to address income inequality

through measures other than fiscal policy, including regional factors, industrial policy and macro policies designed to increase the share of consumption in GDP.

## 2. Public Spending on ‘merit goods’

When it comes to the incidence of public expenditure by functional outlay, some interesting trends can be discerned. The total outlays on education by all the EME have increased over time. (Figure B.2.1) On an average, all the EME spend less than 5% of their GDP on education (except Brazil which has started spending more than 5% since 2006) for the entire period 1995-2011. A discouraging feature, however, is the share of public spending in total outlay on education in these economies. (Table B.2.1) In no case, public spending on education is greater than 20% of total spending. This indicates that spending on education has not really been a priority on the public policy agenda for these economies.

**Figure B.2.1: Education Spending in the Emerging Mega Economies  
(% of Gross Domestic Product)**



Source: World Development Indicators

**Table B.2.1: Education Expenditure, Public (% of Total Education Expenditure)**

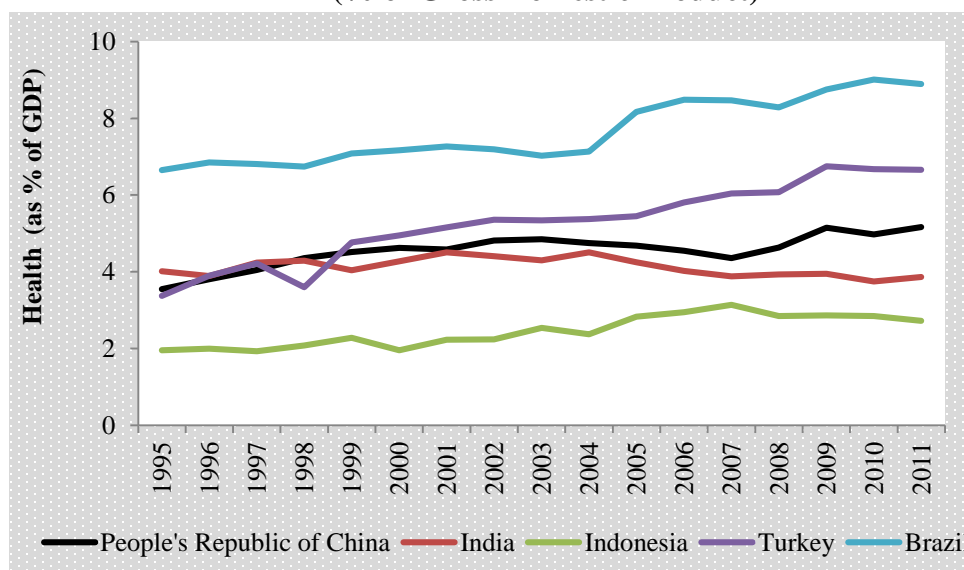
Year	People's Republic of China	India	Indonesia	Turkey	Brazil
1995	14.6	-	6.1	-	-
1996	15.2	-	7.5	-	-
1997	-	11.1	7.7	-	-
1998	12.5	13.0	-	-	11.5
1999	11.4	16.3	-	-	9.5
2000	-	16.4	-	-	11.4
2001	-	-	11.2	-	10.6
2002	-	-	14.1	6.5	9.6
2003	-	11.5	16.3	7.1	-

2004	-	10.8	13.8	8.8	11.1
2005	-	10.7	15.3	-	12.0
2006	-	10.4	-	8.6	13.0
2007	-	-	15.0	-	13.2
2008	-	-	13.6	-	14.1
2009	-	10.1	19.3	-	14.8
2010	-	10.5	16.4	-	14.6
2011	-	11.3	15.0	-	-

Source: World Development Indicators

Health spending by EME is greater than their outlays on education. All the EME have experienced a steady increase in total spending on health except India, which shows a decline in its total expenditure on health sector. (Figure B.2.2) The share of public spending in total outlay on health is highest in Turkey followed by PRC and Brazil. India, again, performs the poorest on this score.

**Figure B.2.2: Health Spending in the Emerging Mega Economies  
(% of Gross Domestic Product)**



Source: World Development Indicators

**Table B.2.2: Health Expenditure, Public (% of Total Health Expenditure)**

Year	People's Republic of China	India	Indonesia	Turkey	Brazil
1995	50.5	26.0	35.7	70.3	43.0
1996	46.6	25.7	36.4	69.2	40.5
1997	44.2	25.1	35.0	71.6	43.0
1998	41.8	25.6	34.1	71.9	42.6
1999	40.9	28.0	34.6	61.1	42.7
2000	38.3	26.0	36.1	62.9	40.3
2001	35.6	23.9	43.2	68.1	42.3
2002	35.8	23.2	38.1	70.7	44.6

2003	36.2	22.8	40.1	71.9	44.4
2004	38.0	20.9	39.5	71.2	47.0
2005	38.8	22.1	32.3	67.8	40.1
2006	40.7	23.5	35.2	68.3	41.7
2007	46.9	24.7	39.7	67.8	41.8
2008	49.9	26.3	40.2	73.0	42.8
2009	52.5	27.6	40.0	75.1	43.6
2010	54.3	28.2	36.1	74.8	47.0
2011	55.9	31.0	34.1	74.9	45.7

Source: World Development Indicators

The data on education and health, at first sight, confirm that the EME as a group does not exhibit any specific discernible pattern of spending on education and health. If anything, as said earlier, then the expenditures are correlated with levels on income. Thus, Brazil is spending relatively high percentage of GDP on education and China spending relatively less. In the case of Indonesia and Brazil the state has clearly taken a policy decision to increase its relative share on education spending; the opposite seem to be true for India where, despite a marginal increase in education outlays relative to total public spending, the share of public education spending as percentage of total expenditure has fallen as the economy “emerged”. In case of health, China and Turkey, and to a lesser extent, Brazil, account for significant levels of health spending. The data for Indonesia and India do not reflect a similar policy stance.

It, therefore, appears that there is some scope to increase the focus on health, either through raising total current expenditures (if possible) due to reasonable current fiscal surpluses, or if current surpluses are low or lacking by changing policies to favor health spending. In case of Brazil and Turkey, there is a need for policy revisions focused on stepping up health spending as health impacts the human capabilities and participation in growth process both in short as well as in the long run.



### 3. Fiscal Space, Inclusive Growth and Savings

The story of macro-fiscal stability is at first told by the extent to which revenues cover public expenditures. A golden rule of fiscal policy is that current expenditures should, at least, be covered by current revenues. It is clear that this rule is meticulously followed by PRC and Indonesia with a clear exception of India. Lack of data availability does not allow inferences about Brazil and Turkey in this case. (Table B.3.1)

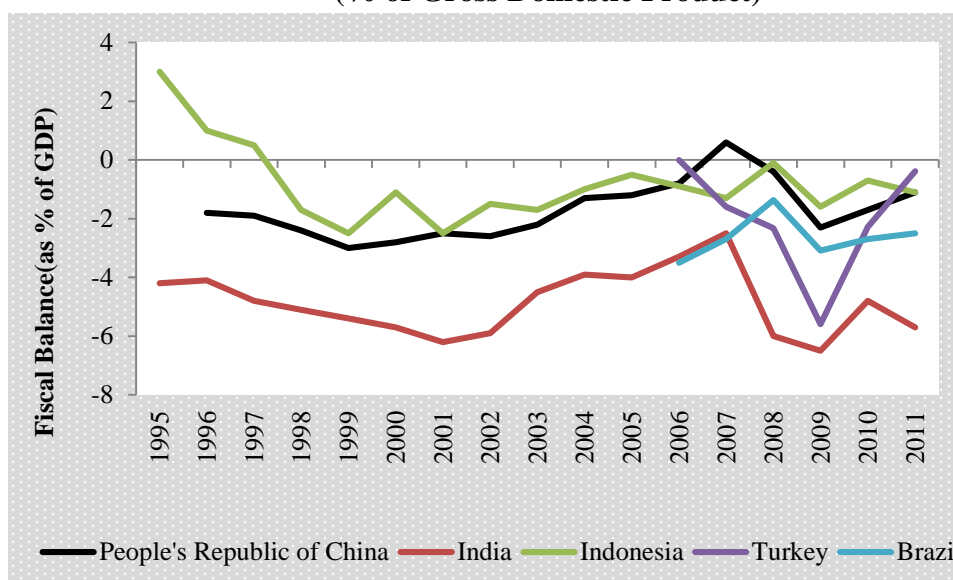
Table B.3.1: Current Surplus/Deficit (as % of GDP)

Year	People's Republic of China	India	Indonesia	Turkey	Brazil
1995	1.8	-2.5	9.8	-	-
1996	1.2	-2.4	7.8	-	-
1997	1.2	-3.0	6.6	-	-
1998	0.9	-3.8	4.1	-	-
1999	0.9	-3.5	5.0	-	-
2000	0.9	-4.1	2.0	-	-
2001	1.3	-4.4	5.0	-	-
2002	-	-4.4	6.1	-	-
2003	-	-3.6	1.7	-	-
2004	-	-2.4	1.6	-	-
2005	-	-2.5	0.6	-	-
2006	-	-1.9	0.7	-	-
2007	-	-1.1	0.3	-	-
2008	-	-4.5	1.3	-	-
2009	-	-5.2	-0.3	-	-
2010	-	-3.2	0.5	-	-
2011	-	-4.4	0.4	-	-

Source: Author's Calculations using ADB Database, Country Profiles

As far as overall fiscal balance goes, while fiscal deficit limits are determined by national characteristics and policy limits such as fiscal rules, it is interesting to note that EME in fact operates at reasonable levels of fiscal prudence. (Figure B.3.1) In the EME, again the PRC and Indonesia run moderate fiscal deficits but India has been unable to reduce its deficits to its own Fiscal Responsibility and Budget Management Act targets over the last 16 years. Though Brazil and Turkey run higher fiscal deficits compared to PRC and Indonesia, the performance of the former economies is still better than India.

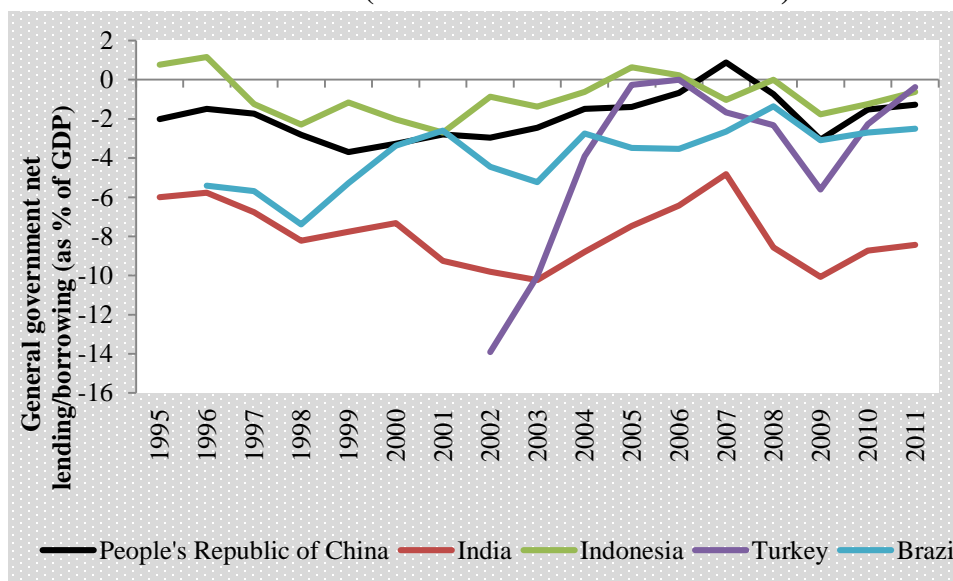
**Figure B.3.1: Fiscal Balance in the Emerging Mega Economies  
(% of Gross Domestic Product)**



Source: Data for India, People’s Republic of China (PRC) and Indonesia is sourced from ADB Country Profiles Database. Data for Turkey and Brazil is sourced from Fiscal Monitors Database, IMF.

Note: Data refers to central government for India, PRC and Indonesia. Data refers to general government for Turkey and Brazil.

**Figure B.3.2: General government net lending/borrowing in the Emerging Mega Economies (% of Gross Domestic Product)**



Source: World Economic Outlook Database, IMF

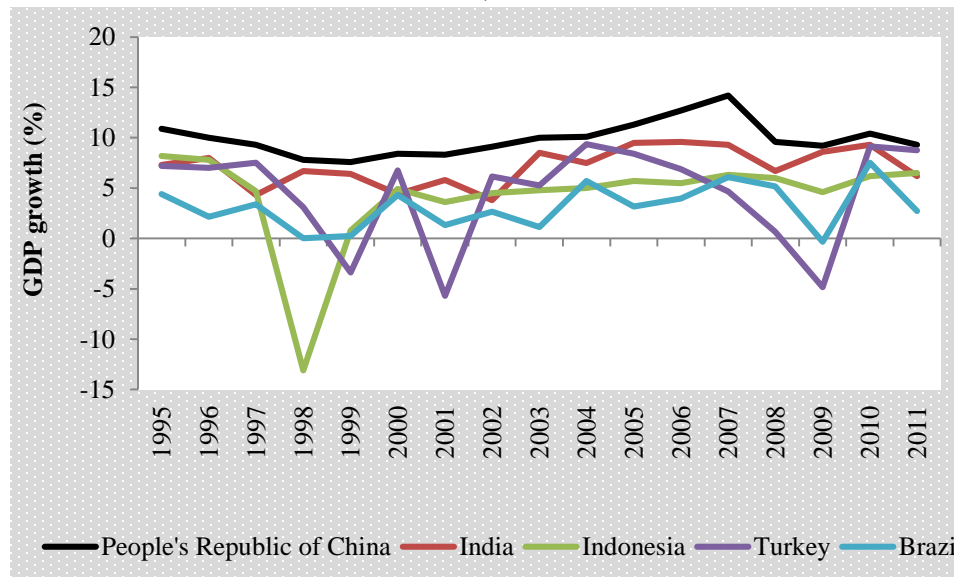
An important question that arises here is whether the EME tend to finance their deficits domestically thus limiting concerns regarding spillovers. Both PRC and Indonesia have a low borrowing-GDP ratio. (Figure B.3.2) Turkey observed a significant decline in its borrowing-GDP ratio from almost 14% of GDP to less than 1% in 2011. Brazil also experienced a steady

decline in its borrowing-GDP ratio. India remains an outlier with the highest borrowing-GDP ratios. Though all the EME faced a one-time hike in their borrowings in the year 2009, they all seem to have tried to resort to their long term trends afterwards. This in conjunction with their fiscal and current balance indicating that probably except India, no other EME is borrowing to consume but for investment. If so, then, ipso-facto, this leaves more room at the top for fiscal space in EME.

Thus, there is fiscal space to invest in inclusive growth in EME; however, there are some important exceptions like India where the golden rule is consistently violated. Until the tax effort improves, there is extremely limited room to increase spending in India. The borrowing patterns also are stable in EME and are not a constraint to inclusive growth.

As highlighted earlier, a prerequisite for inclusive growth is that growth is sustainable and at levels to allow for public spending targeted at improving human capacity. Further, it allows building necessary economic and social infrastructure to boost inclusivity in the economy. Also, if growth exhibits high volatility in long run then scarce fiscal resources can be diverted to stabilization and can constrain the fiscal space for inclusive growth. Thus, in certain situations, if prudent fiscal policies do not sufficiently stimulate economic activity; then such policies may act as a constraint on growth.

**Figure B.3.3: Real Gross Domestic Product Growth in the Emerging Mega Economies, 1995–2011**



Source: Data for India, People’s Republic of China (PRC) and Indonesia is sourced from ADB Country Profiles Database. Data for Turkey and Brazil is sourced from World Economic Outlook, Country Profiles Database (April2014), IMF.

Examining trends and looking at median growth figures in the EME reveals that growth rates have not been low in the medium term, thus, prudent fiscal policies have not obviously retarded growth in EME.(Figure B.3.3)

The main interest here is to see whether there are any sharp changes in inclusion within and across EME that can in any reasonable way to be linked to the design and articulation of fiscal policies. Here, the lack of adequate comparable data is a problem.

Income and consumption inequality is one popular measure of the extent to which growth is inclusive. The Gini coefficient is a measure of income and consumption inequality while inclusion is better measured by changes in the income shares of the highest versus the lowest quintiles on the assumption that given the virtual absence of redistributive welfare measures in the fiscal policies of EME, changes in this ratio would be influenced by changes in the intensity of use of factor endowment and/or factor prices of those factor endowments that belong to populations in the lowest quintiles. (See Roy 2011). The most striking cases of worsening ratios are the EME. (Table B.3.2)These are also the fastest growing and most dynamic economies in the world; and it would be imprudent to draw any conclusions about the link between this and the conduct of fiscal policy. More detailed research would be required to establish any correlations.

Table B.3.2: Gini Index

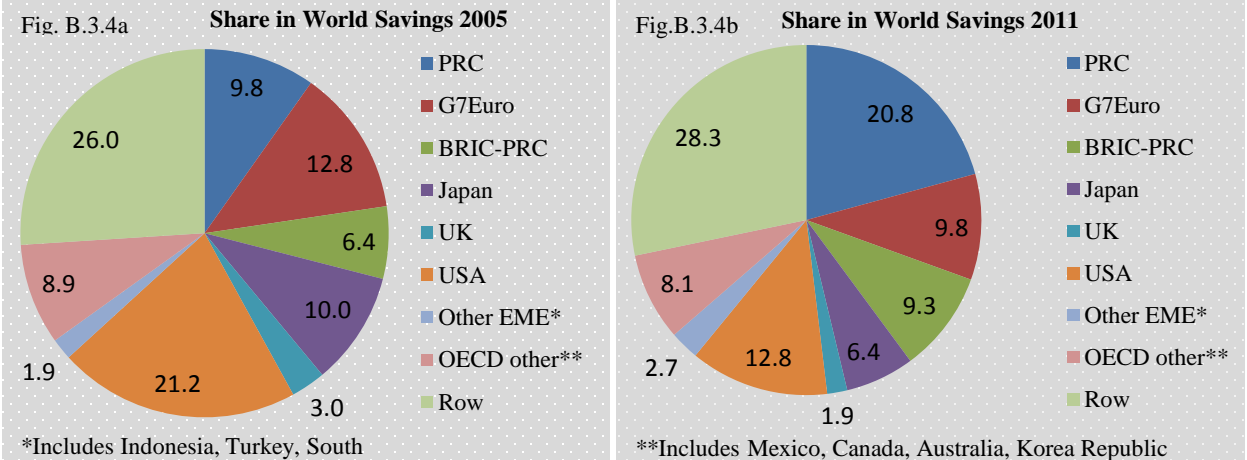
Year	People's Republic of China	India	Indonesia	Turkey	Brazil
1995	-	-	-	-	60.2
1996	35.7	-	31.3	-	60.6
1997	-	-	-	-	60.5
1998	-	-	-	-	60.4
1999	39.2	-	29.0	-	59.8
2000	-	-	-	-	-
2001	-	-	-	-	60.1
2002	42.6	-	29.7	42.7	59.4
2003	-	-	-	43.4	58.8
2004	-	-	-	42.7	57.7
2005	42.5	33.4	34.0	42.6	57.4
2006	-	-	-	40.3	56.8
2007	-	-	-	39.3	55.9
2008	42.6	-	34.1	39.0	55.1
2009	42.1	-	-	38.7	54.7
2010	-	33.9	35.6	40.0	-
2011	-	-	38.1	-	-

Source: World Development Indicators

The global pool of savings—not the savings–GDP ratio which is the stock-flow counterpart that measures the size of the savings flow compared to GDP—is pertinent in assessing EME role and contribution to the future of global development. The fact that the global pool of savings is sufficient to address development challenges after the 2015 deadline for achieving the MDGs is well recognized by those tasked to think about development financing (e.g. Sheng 2013). The United Nations (UN 2013) too asserts that, “The money is there—world savings this year will likely be over \$18 trillion.”

USA and the G7 Eurozone (France, Germany, and Italy) shared more than 30% of global savings in 2005. (Figure B.3.4a) The G7 (including Japan) as recently as 2005 generated more than 40% of global pool of savings despite the rise of the PRC and more recently Brazil, the Russian Federation, and India (BRIC).

**Figure B.3.4a: Shares of World Savings in 2005**      **Figure B.3.4b: Shares of World Savings in 2011**



Note: BRIC=Brazil, Russian Federation, India, and the People’s Republic of China, EME=emerging mega economies; Euro=Eurozone; OECD=Organisation for Economic Co-operation and Development; PRC=People’s Republic of China; RoW=rest of the world; UK=United Kingdom; USA=United States.

Source: World Development Indicators.

However, there has been a remarkable shift in the share of savings in recent years (Figure B.3.4b). In 2011, the PRC accounted for the highest share in world savings followed by the US, and the other BRIC economies contributed savings comparable to the G7 Eurozone and exceeding those of Japan.

Table B.3.3: Descriptive Statistics of Change in Share of EME in World savings

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

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

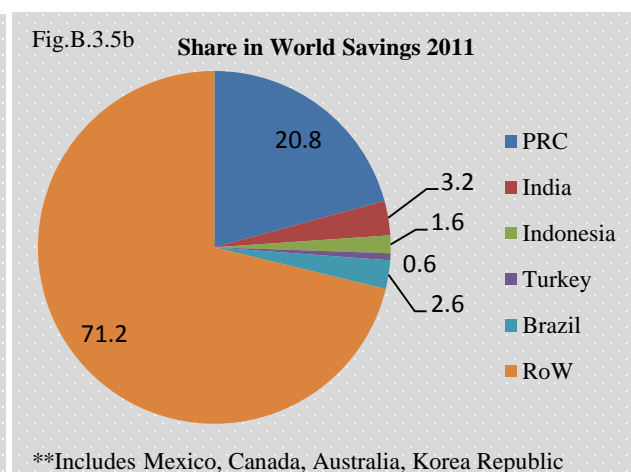
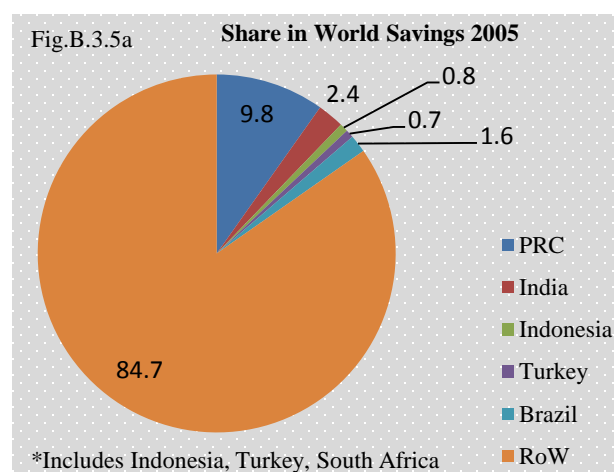
Source: Author’s calculations based on Data from World Development Indicators.

Table B.3.3 explains the dynamics of changing patterns of share in global pool of savings. PRC accounts for more than 10% of global savings for the period 1995-2011. The other four EME accounted for 5.3 % of world savings in the same period. However, the dynamics shifted strongly in favor of EME after 2005. The average share of PRC in world savings increased to 15.4% for the period of 2005-2011 as compared to just 6.5% in 1995-2005. In other words, this meant a net gain of 8.9 percentage points between the two sample periods. The other four economies together also gained 2.4% in their share of global pool of savings.

This affects EME dramatically (Figures B.3.5a and B.3.5b).

Figure B.3.5a: Shares of World Savings in 2005

Figure B.3.5 b: Shares of World Savings in 2011



Source: World Development Indicators

This rapid increase in the share in global savings of EME has a significant positive impact on global fiscal stability. The only country where the “draft” of public sector spending on domestic savings is high is India. India is also remarkable for the extent and magnitude of borrowing to finance government consumption measured by the current fiscal deficit, a phenomenon that India has failed to address in recent years.

In addition, there are two important considerations here. First, while Brazil and Asian EME have seen a remarkable increase in their savings-GDP ratios and investment-GDP ratios; Turkey did

not. On an average, PRC has high and stable ratios at between 40-50%, while India and Indonesia observed between 25-35%. In case of Brazil and Turkey, the ratios are as low as in the range of 15-20% with few exceptions.

Second, given the fact that the Asian EME vary in terms of fiscal stance and investment financing requirements from Brazil and Turkey, this may also pose political economic conflict of interests amongst EME for co-ordination. Lack of co-ordinated policy dialogue in such case would result in loss of the comparative advantage that EME has gained on global resources in the last few years.

### **C. The Impact of Countercyclical Fiscal Policy on Growth and Inclusion**

There is constant tension for governments between (i) securing fiscal prudence and maintaining predictability in the course of fiscal policy and (ii) the pressure to expand spending on public goods and to moderate tax burdens to secure inclusive growth. That pressure is particularly pronounced in times of fiscal stress. When there is an exogenous shock that threatens a recession, there is pressure on governments to run expansionary countercyclical fiscal policies and to suspend fiscal rules and other prudential commitments until the crisis is weathered.

In the case of India, the economic crisis coincided with national elections, so a fiscal expansion had already been undertaken just prior to the onset of the global crisis. A fiscal stimulus equivalent to 4% of GDP was introduced in the central government's 2008 budget. The crisis also impacted state finances with the result that the combined fiscal deficit grew to 11.4% of GDP that year. While this had serious implications in future years for India's sovereign ratings, given its high and rising current account deficit and poor growth performance, the immediate fiscal sustainability implications in terms of debt dynamics were not negative as feared by some commentators at the time (Kumar and Vashisht 2009). Thus, India's public debt-GDP ratio actually declined from 73% in 2008-2009 to 66.36% in 2011-2012.

Why was this the case? To some extent, it was because the tradition of fiscal prudence for both central and state governments set in place by the 12th Finance Commission (2004) and reinforced by the 13th Finance Commission (2010) led to increased fiscal discipline at the state level. State deficits thus declined to more manageable levels shortly after the crisis. On the other hand, with inflation at around 10%, the nominal value of GDP continued to rise faster than the nominal value of debt. Thus, debt sustainability ratios stayed under control. In addition, the low ratio of external debt to total debt in India and the extremely high proportion of long-term debt in total debt meant that debt management was relatively easy. So debt sustainability did not threaten India's macroeconomic fundamentals; rather, the fact that the fiscal stimulus did not result in the expected growth response—India underperformed on growth compared to the other EME and indeed compared to the other BRIC economies—led to increasing macroeconomic difficulties for India and the consequent pressure to reduce deficits and therefore fiscal space.

In the case of the PRC, the government provided a massive fiscal stimulus equivalent to 14% of GDP for fiscal year (FY) 2008 and FY2009 (Yongdin 2010). This included a fiscal stimulus that is expected to result in a fiscal deficit of 3% of GDP in 2009; however, the PRC had plenty of fiscal space to begin with. Fiscal deficits had fallen to below 2% of GDP by 2004 and to less than 0.5% of GDP in 2008; the highest fiscal deficit incurred was therefore just 2.3% of GDP in 2009. The 9.6% median growth rate from 1995 to 2011 was maintained thus fiscal expansion was accompanied by the requisite growth payback ensuring fiscal sustainability.

Indonesia went through a fairly long process of fiscal reforms that included reforms in public financial management as well as significant structural changes in intergovernmental fiscal relations following the 1997 Asian financial crisis. The fiscal deficit–GDP ratio declined continuously. The median fiscal deficit from 1995 to 2011 was therefore a very low 1.1% of GDP with a concomitant decline in the debt–GDP ratio over time. Indonesia also had in place a fiscal rule that limits the fiscal deficit to 3% of GDP and the ceiling debt–GDP ratio to 60% of GDP (Basri and Rahardja 2011)

Indonesia's 2009 fiscal stimulus package involved an expansionary fiscal policy as well as tax cuts. Over two-thirds of the stimulus came from tax cuts and the rest through increased public spending and subsidies (Hur et al 2010); however, this increase did not breach the fiscal rules. Chiefly due to the government's inability to increase public spending, the 2010 fiscal deficit was 0.7% of GDP against a target of 1.3% (Basri and Rahardja 2011). As a consequence, both revenues and expenditures fell as a percentage of GDP from 2008. Thus in Indonesia's case, the fiscal stimulus was not expansionary but rather involved stimulating the private sector through tax cuts and a fall in the G–GDP ratio.

Brazil's response to the crisis was publicly heralded by its government in a sequence of expansionary actions unprecedented in the country's recent economic history and in sharp contrast to the contractionary policies adopted in 1980s and 90s. However, an important segment of this expansionary policy stance was adopted before the crisis. Five structural initiatives (Barbosa 2010) were adopted prior to 2008. These were:

- i. The expansion in the mechanisms of social protection
- ii. The increase in the minimum wage
- iii. The expansion in public investment
- iv. The tax cuts associated with Brazil's new industrial policy; and
- v. The restructuring of the government's career and payroll expenditures

The second feature which marks Brazil from other economies is the active use of monetary policy to a) provide liquidity in both domestic and foreign currency and b) a substantial cut in its base interest rate.

The fiscal expansion was generous amounting to 6.25% of GDP.(Table C.1) However, like India and China, Brazil expanded public expenditure rather than opting for tax cuts. Infact, an additional income tax of 0.1% of GDP was imposed to partially finance the expenditure



expansion. Thus, reduction in tax incidence on the private and household sector amounted to just 0.7% of GDP.

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

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

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

<http://www.degruyter.com/view/j/jgd.2010.1.1/jgd.2010.1.1.1052/jgd.2010.1.1.1052.xml>

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After long history of macroeconomic instability, Turkey, after the 2001 crisis, undertook important reforms which have been largely successful. These include monetary policy governed by an independent Central Bank with an inflation targeting framework, a restrained fiscal policy resulting in a typically stable and occasionally declining public debt/GDP ratio, and well regulated and supervised banks with strong balance sheets.

However, Turkey continued to face a widening external account deficit and despite reasonable growth rates and macro stability, a falling domestic savings-GDP ratio. This meant that while Turkey had strong macroeconomic foundations, its structural problems limited the scope for expansionary countercyclical fiscal policies. (Rodrik 2012)

Remarkably, Turkey's revenue-GDP ratio in fact rose through the crisis period. This was not because Turkey increased tax rates across the board (except raising tobacco and fuel taxes in 2009). The rise in tax revenue was generated principally through increase in tax base using one-off schemes like voluntary disclosure, tax amnesty and asset repatriation programmes. The focus of Turkey's fiscal stimulus was, therefore, on expenditure measures (Table C.2)

The G/GDP expanded principally through a sustained increase in government investment expenditure though government consumption expenditure also rose up by 0.5% of GDP. There were also significant increase in transfers to households and sub-national governments.

Table C.2 Fiscal Stimulus in Turkey

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

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

<http://www.oecd->

[ilibrary.org/docserver/download/5km36j7d320s.pdf?expires=1407741974&id=id&accname=guest&checksum=3DA96EC5DE302C071F531C2F64A17C33](http://www.oecd-ilibrary.org/docserver/download/5km36j7d320s.pdf?expires=1407741974&id=id&accname=guest&checksum=3DA96EC5DE302C071F531C2F64A17C33)

<http://dx.doi.org/10.1787/5km36j7d320s-en>

Yet the total stimulus peaked at 2% of GDP in 2010 and was swiftly decelerated following that date. Fiscal sustainability was, therefore, not compromised with revenue increases paying, in large measures, for the stimulus.

Thus, these economies followed very different strategies with very different outcomes after the 2008 financial crisis. The chief impact on inclusive growth seems to have been driven by the impact of the fiscal stimulus on growth. All EME tried to maintain fiscally prudent policies in administering the fiscal stimulus, even India. It was the failure of the fiscal stimulus to maintain growth that resulted in concomitant pressures on economic activity chiefly through inflation, high nominal interest rates, and rising current account deficits in that country. In no case, was debt sustainability impaired by fiscal expansion.

## D. Concluding Observations

When assessing fiscal stance in the five EME covered in the paper, we find that revenue trends show no congruence. PRC, Brazil and Turkey record a steady rise in their revenue-GDP ratios while India and Indonesia display a discernible revenue gap. Hence, it continues to be the case following Hinrichs (1966) that tax and revenue performance are correlated strongly with levels of GDP rather than to be with high growth per se.

Similarly, lower income EME (India and Indonesia) spends less than high income EME (Brazil and Turkey). The case of PRC is exceptional in the sense that despite high growth and GDP levels; the G-GDP ratio remains constant. PRC has not yet attempted large scale redistributive measures through fiscal policy to address rising income inequality.

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

All the EME other than India run current surpluses {Total Revenue-(Government Consumption + Transfers + Subsidies + Interest on Debt)}. Thus expansionary fiscal policy is feasible in the medium term except for India which will need to undertake either substantial expenditure switching within its current expenditure portfolio or implement policies that significantly increase revenue-GDP ratio to levels comparable to other EME.

The EME benefit from a dramatic change (as we see from Table B.3.3); four of the five EME studied here have seen increase in the share of mean savings even as the rest of the world observed a reduction. While the change is significantly led by PRC, the combined contribution of other EME is by no means trivial. In the case of Asian EME, this increase in share is underpinned by high savings-GDP ratios. In the case of Brazil, the share is relatively low but has risen appreciably over the past decade. Turkey continues to be an outlier amongst EME on this account.

The EME show that countercyclical fiscal policies deployed, have been tailored to individual circumstances, and have been mindful of prudential limitations thus alleviating the fear that persistence with such policies would jeopardize fiscal prudence. Even in the case of India which has been going through some recent macroeconomic difficulties, it is supply side constraints and balance of payment difficulties that have caused problems in macroeconomic management rather than the inability to speedily tone down countercyclical fiscal policies.

As far as inclusion goes, this paper does not find any dramatic, first-order link between performance in individual measures of inclusion and the conduct of fiscal policy. In the EME, there is an apparent case for redistributive measures to address the increase in top–bottom inequity in consumption, and this may be feasible consistent with fiscal prudence for the PRC alone. In all other EME, inclusion is best served by using fiscal policy as an instrument to maximize public spending on merit goods and to secure a growth maximizing macro-fiscal environment.

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