Mobilizing state revenues for productive and social transformation

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The issue

- How can developing countries mobilize revenues for social and productive transformation?
- How can fiscal reforms expand policy space and contribute to productive and redistributive goals?
- What are specific opportunities and constraints in mineral-rich countries?
- What are linkages between the politics of domestic resource mobilization and domestic capabilities?

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Financing social + productive transformation

- Resource mobilization
- Efficiency gains / Fund reallocation

- Revenue sources
  - Taxation/Contributions
  - Aid / Borrowing
  - Remittances/OOP
  - Mineral Rents
- Financing techniques
  - private/public
  - funded/PAYG
  - Direct/indirect tax
- Expenditure choices
  - Social services
  - Social protection
  - Labour market policies
  - Industrial policies

The crisis and finance for social development

- Foreign capital/aid and domestic credit
  - Financing costs (internal/external)↑
- Trade and FDI
  - tax revenues↓
- Commodity prices and Terms of Trade
  - tax revenues↓
- Remittances↓ Household income ↓
- Social expenditures ↑, subsidies ↑

Refocus on importance of domestic resource mobilization (Monterrey Consensus etc.)

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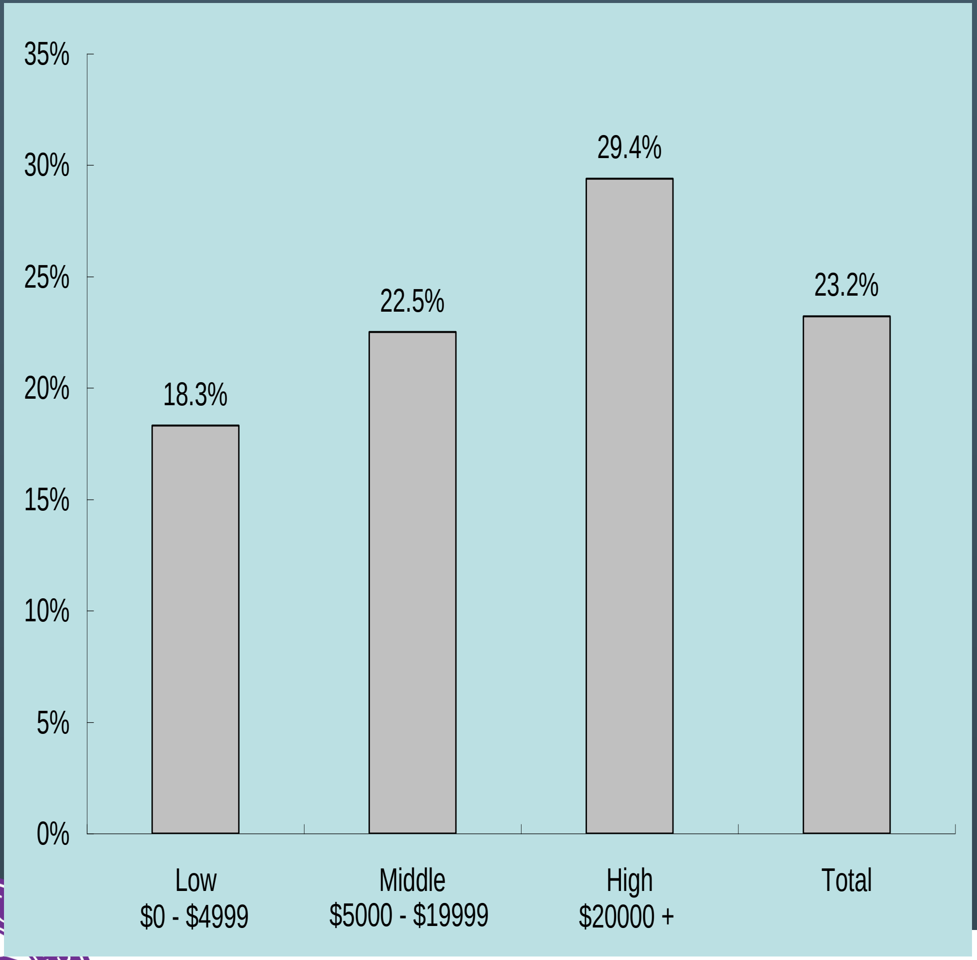
Fiscal Space

- Budgetary room to finance public policies in a sustainable way (honour debt obligations, maintain solvency ..)
- **Expanding fiscal space:**
  - Reallocation of existing revenues/efficiency gains
  - Mobilization of additional revenues
- **Estimating fiscal space:**
  - Compare actual expenditure with benchmarks
  - Compare actual expenditure with costs of basic package (SPF)
  - Assess space to increase tax revenues or public borrowing (Oxfam Report, IMF)

Mobilizing Revenues

- Tax reform
- Extension of contributory systems (social insurance)
- Capture of mineral rents
- Trade, tariffs
- Foreign aid
- Domestic and external borrowing, FDI
- Public-private partnerships
- Private funds (HH income/savings, remittances)

Tax Revenue as % of GDP by country group



The aggregate view: tax shares as % of GDP rise with income level

Source: Bird and Zolt (2005).

Tax Reform

- Tax reform remains a key challenge for developing countries.
- Taxation
  - Is superior to other revenues in terms of distributional justice and to reach universal coverage
    - <u>Direct taxes</u> have greater potential in terms of progressivity / redistribution / solidarity
    - <u>indirect taxes</u> (VAT): design matters for redistribution
    - trade - tariffs ↓
  - *Can* enhance strong state-society relations and state accountability (all contribute, all benefit)
  - Is more sustainable than external revenues

Political-economy of taxation

- Tax incentives (FDI), race to the bottom, tax evasion, capital flight etc.
- More convincing to argue for progressive direct taxation if public/social expenditures benefit all (universalism)
- To overcome obstacles towards direct taxation, find <u>functional equivalents</u>:
  - Marketing boards
  - Land/export taxation etc.

<u>Key questions</u>

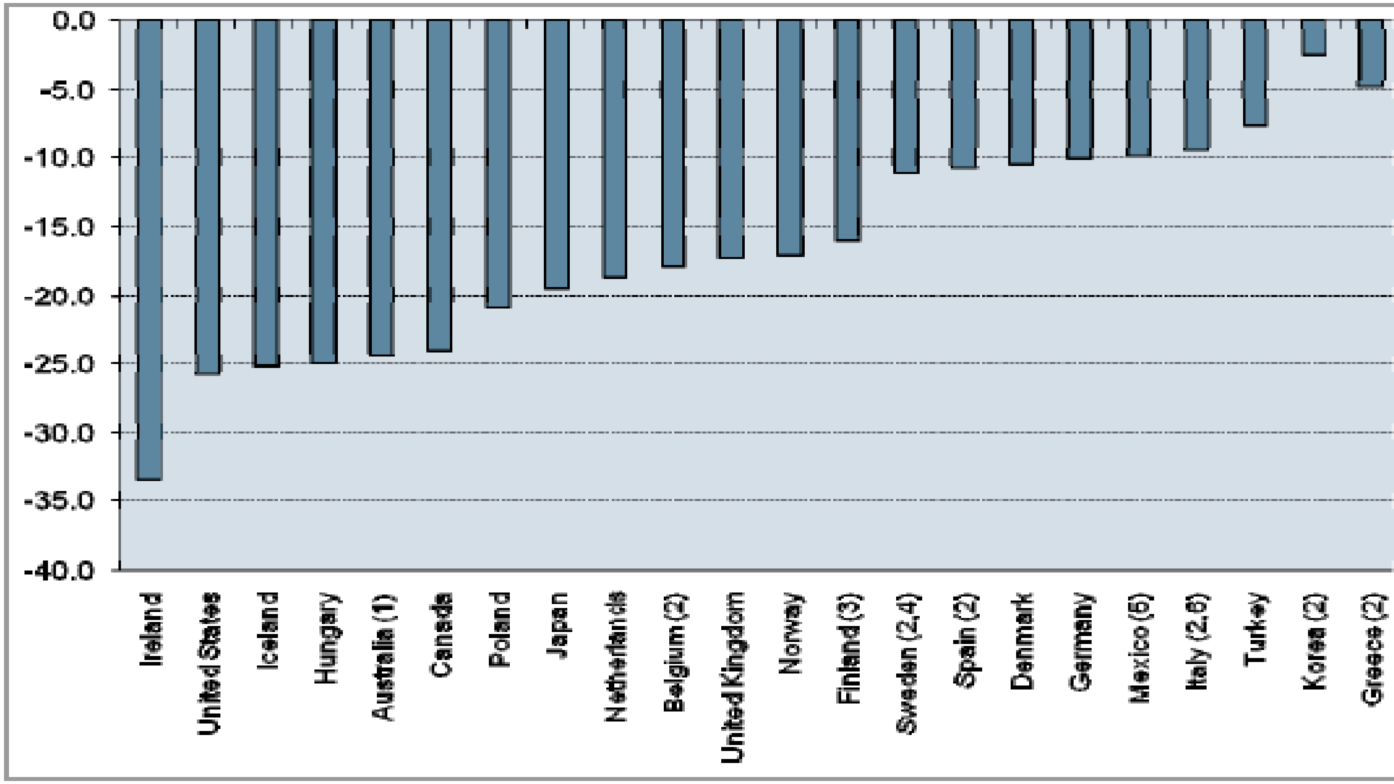
- What are the political conditions for progressive tax reforms + better tax deals with foreign investors and MNCs?
- Who are the actors involved in bargaining and negotiation processes?
- What are the linkages with social development policies?

Pension Funds

- Pension funds have been a major financing source for investment (combination of protective and productive role of social policy)
- Investment policies and economic context crucial:
  - Structural reforms (from PAYG to IFF): privatizing public pension systems implies high transition costs for governments!
    - Chile: transition costs 30 years (declining from 4.7 to 1.5% of GDP per annum)
  - Protecting accumulated funds: danger of decapitalization (low or negative rates of return, financial and economic crises)

Risk of Pension Funds

Figure 6. Pension fund returns (real), for selected countries, January–October 2008 (percentages)



[1] Official data up to June 2008 then complemented by OECD estimate up to October. [2] 2008 data refer to 30 September 2008. [3] Data refer to statutory earnings-related pension plans. [4] Data refer to occupational pension plans only. [5] Data refer to the mandatory and voluntary pension systems. [6] Data refer to new pension funds (contractual and open) instituted after 1993 legislation.

Source: OECD.

Aid

- Aid (still) indispensable for low-income countries
  - To achieve social development + poverty reduction
  - Cushion impact of global and national crises
- Instrument of international redistribution

BUT

- Aid usually procyclical, volatile and costly in administrative terms
- Potentially negative impact on
  - Macroeconomy (Dutch disease, conditionality)
  - Accountability and state-citizenship relations

Net financial transfers to developing countries, 1995–2008 (selected years/billions of dollars)

	1996	*1998*	*2000*	*2002*	*2004*	*2006*	*2008*
Africa	-8.4	13	-31.4	-5.1	-36.4	-78.8	-125.9
Sub-Saharan Africa (excluding Nigeria and South Africa)	5.2	11.9	3	4.5	2.5	-8.4	-28.6
East and South Asia	18.9	-128	-119.8	-145	-177.7	-375.2	-431.9
Western Asia	10.6	34.2	-31.4	-19.7	-70.7	-158	-315.6
Latin America and the Caribbean	-0.5	43.1	-2.8	-30.4	-80.6	-108.8	-60
Transition economies	-8.7	0.7	-51.5	-28.6	-63.3	-124.6	-171.2
Memorandum							
– HIPCs	6.7	8.5	8.2	12.4	12.8	12.8	26.1
– Least developed countries	11.5	13.5	6.6	9.6	[illegible]	[illegible]	[illegible]

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Remittances

- Remittance euphoria widespread: remittance flows often higher than FDI, ODA or export revenues
- Private transfer, remittances finance social outcomes

Remittances and Social Development

- Positive Development Impact
  - Stable inflow of FOREX, counter-cyclical (although not in case of global crisis!)
  - Increase income, consumption and social protection, foster investment
- Problems
  - What about migration causes and negative effects like brain drain (and brain waste), care drain, social disintegration etc.?
  - Remittance dependency
  - Dutch disease

Remittances and socio-economic investment

- Remittances finance out-of-pocket payments for health and education and small investments in productive assets
- Special programmes crowd-in co-financing from the State (Mexican 3:1)
- Evidence from Latin America shows, that remittances can lead to higher tax receipts (positive effect on local economies)
  - Fiscal linkage for financing socio-economic transformation

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Mineral wealth: Blessing or Curse?

- Resource curse thesis ⇨ empirical works by Richard Auty and by Sachs and Warner (1995) followed by many others – dominates global debates on natural resource-led development
  - Negative relationship between natural resource abundance and growth performance
  - causal relationship exists that explains this negative link
- Main criticism
  - methodological issues
  - deterministic conclusions
  - pessimistic prospects

- **⇨Interesting question is to identify specific challenges of mineral-led development and how to overcome these**

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Natural resource based sectors drive growth because…

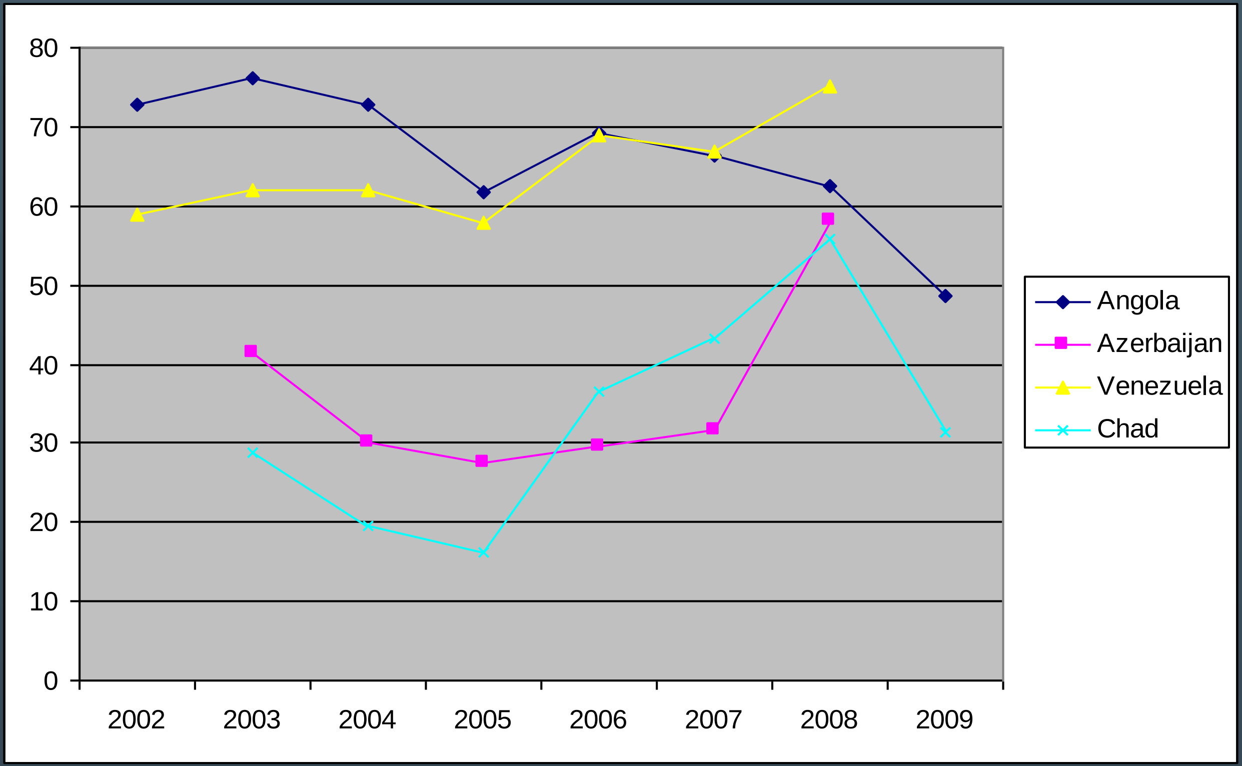
– Global demand/prices ↑ (India, China)
– Incentives for investments ↑ (portfolio and FDI)
– New technologies (exploration, extraction)
– Path dependency of growth models based on natural resources
– Impact of neoliberal policies and globalization on domestic production (manufacturing): reorientation towards comparative advantages: « reprimarización »

The challenges of mineral-led development I

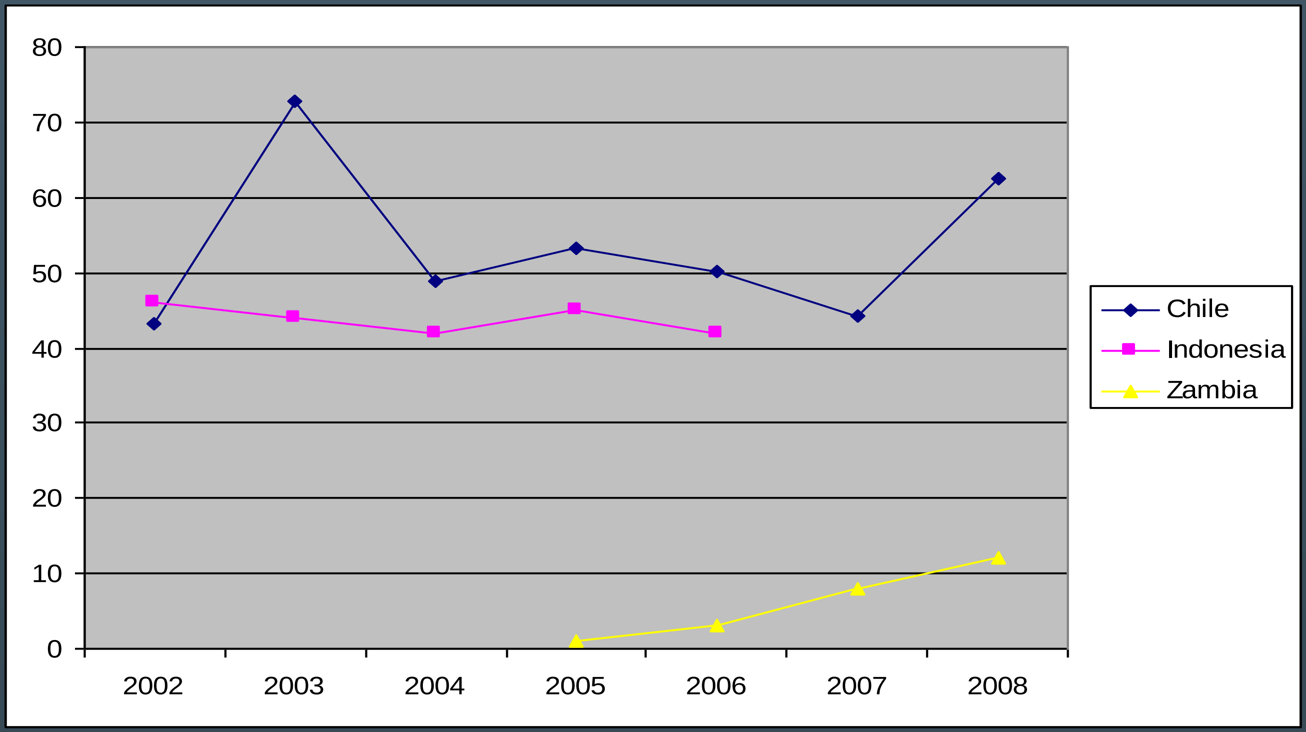
- **Economic challenges**: Dutch disease, price and revenue volatility, terms of trade, enclave nature of mineral production, limited employment creation, limited incentives for skills investment and education

- **Political challenges**: who captures rents (foreign investors, private investors, state, elites)? How are mineral rents invested, revenues spent? Rent-seeking and corruption? Distributional conflicts? Access to rents finances violent conflict or undemocratic regimes?

Share of government revenues in oil rent (in % of total, UNCTAD TDR 2010)



Share of government revenues in copper rent (in % of total, UNCTAD TDR 2010)



The challenges of mineral-led development II

- **Social challenges**: inequalities (income, regional, gender, ethnic/indigenous peoples' rights), potential fragmentation of social systems

- **Environmental challenges**: ecological costs associated with EI: depletion; pollution and destruction of environment; climate change

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The long term objectives of a mineral-led growth path are

- Stability and sustainability
- Diversification, productive linkages, higher value added, exports, qualified and well-paid jobs
- Inclusive and democratic development

What role can social policy play?

- Positive role of social policy for mineral-rich developing countries neglected because:
  - Focus on challenges of macroeconomic stabilization and good governance
  - SP mainly interpreted as a threat to stability or as means to perpetuate predatory or undemocratic regimes („populist-redistributive regimes“)
- However, investment in social policy produces multiple benefits for the entire economy and society while specifically addressing the challenges mineral-rich countries face

Social Policy and the challenges of mineral-led development I

- **Growth and sustainability**: SP contributes to creating an enabling environment for investment and growth; it helps foster knowledge, skills and capabilities for times when minerals are depleted or EI not profitable anymore

- **Stability and Social Protection**: social protection programmes can function as demand stabilizers in a context of high macroeconomic volatility

Social Policy and the challenges of mineral-led development II

- **Employment:** Expansion of employment in social sectors can compensate for reduction of employment in manufacturing in case of Dutch disease effects

- **Gender bias**: Expansion of public employment in social sectors offers jobs for women and is likely to correct part of the gender bias inherent in mineral production

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Social Policy and the challenges of mineral-led development III

- **Social inclusion and cohesion**
- **Political legitimacy**

Mineral rents and socio-economic development

- Build a social consensus on the use of funds:
  - *Norway*: Government Pension Fund Global
  - *Bolivia*: Universal social pension *Renta Dignidad* financed through Direct Hydrocarbons Tax (32% production tax 2005)
  - *Chile*: Extension of Social Pension Coverage (2008)
  - *Botswana*: social programmes and services financed through mineral rents
  - *Indonesia*: fuel subsidies replaced by cash transfer programmes

In addition, successful mineral-led development requires

- Productive diversification
- State capacity
- Consensus building on redistribution of rents and compensation of producing regions
- Sector strategies that minimize environmental and social costs
- Regulation and monitoring of foreign investors and global commodity (and related financial) markets;
- reduced trade barriers for more processed goods
- policy space (capital controls, industrial policies etc.)
- Mobilization of domestic resources such as taxation and social insurance contributions

Domestic resource mobilization and domestic capabilities

- Domestic financing instruments are best suited to create synergies between economic and social development
- External resources have the potential to complement these, especially in low-income countries
- Successful transformation of resources into outcomes depends on political process and quality of institutions + global context
- More sustainable domestic resources linked to social and production-oriented policies increase domestic capabilities: SP have a key role!

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