Common Market for
Eastern and Southern Africa

FISCAL POLICY FOR **INCLUSIVE GROWTH**

Special Report

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This paper provides an introductory note on how to make fiscal policy more inclusive.

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Introduction

In recent years, inequality has risen in many developing countries and despite rapid economic growth in some of them. The widening income gap strengthens the case for a government response, and fiscal policy is one of the most suitable policy instruments to promote a more equitable society that provides opportunities for all. To reduce inequalities and to do distributive justice, the government should invest in those productive channels which incur benefit to low-income groups and are helpful in raising their productivity. Therefore, redistributive expenditure should help economic development and economic development should help redistribution. Taxes also affect poverty as well as income and wealth inequality. Tax policy increases inclusiveness mainly by applying progressive tax system—a tax burden that rises with a taxpayer's income or wealth.

Many studies conclude that if properly designed fiscal redistribution can help support growth because it reduces inequality. Redistributive policies however can generate a tradeoff between equality and efficiency. Design therefore matters, and smart design can help to minimize the adverse effects of redistributive policies on incentives to work, save, and invest.

The objective of this paper is to provide an introductory note on how to make fiscal policy more inclusive. The first part of the paper provides basic concepts on fiscal policy. The second part highlight the link between fiscal policy and inclusive growth. The third part discusses fiscal policy tools for enhancing inclusiveness. The last section provides the conclusions of the paper.

I. Basic Concepts on Fiscal Policy

a) Meaning of Fiscal Policy

Broadly speaking, fiscal policy is concerned with raising and spending financial resources and public debt operations to influence the economic activities of the community in desired ways. It is also concerned with the allocation of resources between the public and private sectors and their use in accordance with national objectives and priorities. It aims at using its three major instruments-taxes, public expenditure and public debt-as balancing factors in the development of the economy. Since the state has come to occupy a pivotal role in the economic development of a country, fiscal policy is being increasingly used, through a policy of taxation of Income, commodities, imports and exports, a well-designed policy of public expenditure and a policy of borrowings, to influence the economic development of the country. Government budgeting is clearly the most important instrument through which the fiscal policy is channeled. In fact, fiscal policy has come to be identified with budgetary policy and the two terms are often used interchangeably.[1]

b) Objectives of Fiscal Policy

The key objectives of fiscal policy include the following among others[2]:

i) **To promote economic growth:** Government promotes economic growth by setting up basic and heavy industries like steel, chemical, fertilizers, machine tools, etc. It also builds infrastructure like roads, canals, railways, airports, education and health services, water and electricity supply, telecommunications, etc. that foster economic growth. Both basic and heavy industries and infrastructure require huge amount of investment which normally the private sector does not take up. Since these industries and infrastructure facilities are essential for economic growth in the country, the burden to set up and develop them falls on the government.

ii) **To reduce income and wealth inequalities:** Government reduces inequalities in income and wealth by taxing the rich more and spending more on the poor. Further, it provides for the employment opportunities to poor that help them to earn.

iii) **To provide employment opportunities:** Employment opportunities are increased by the government in various ways, One, jobs are created when it sets up public sector enterprises. Two, it provides subsidies and other incentives like tax holidays, low rates of taxes etc. to private sector that encourage production and employment. It also encourages setting up of small scale, cottage and village industries by people which are employment

1 Fiscal Policy, Equity and Social Justice, https://egyankosh.ac.in/bitstream/123456789/19301/1/Unit-6.pdf
2 Definition, Types and Objectives of Fiscal Policy,https://www.insightsonindia.com/indian-economy-3/fiscal-policy/definition-of-fiscal-policy/

oriented. This it does by providing them tax concessions, subsidies, grants, loans at low rates of interest, etc. Finally, it creates jobs for poor when it undertakes public works programmes like construction of roads, bridges, canals, buildings, etc.

iv) **To ensure stability in prices**: Government ensures stability of prices of essential goods and services by regulating their supplies. In some countries it incurs expenditure on ration and fair price shops that keep sufficient stock of food stuff. It also subsidizes cooking gas, electricity, water and essential services like transport and maintains their prices at low level which is affordable to the common man. Fiscal Policy can ensure price stability by avoiding excessive levels of budget deficits.

v) **To correct balance of payments deficit:** The balance of payments account of a country records its receipts and payment with foreign countries. When payments to foreigners are more than receipts from foreigners, the balance of payments account is said to be in deficit. Quite often this deficit is caused when a country imports more than it exports. Consequently, the payments on imports to foreigners are more than the receipts from exports. In such a situation, to reduce the deficit in balance of payment account, the government discourages imports by increasing taxes on them and encourages exports by increasing export incentives. However, it should be noted that tax on import is not a popular measure now as it is treated as an obstacle to free flow of goods and services between countries.

vi) **To provide for effective administration**: Government incurs expenditures on police, defense, legislatures, judiciary, etc. to provide effective administration.

c) How Does Fiscal Policy Works?

When policymakers seek to influence the economy, they have two main tools at their disposal—monetary policy and fiscal policy. Central banks indirectly target activity by influencing the money supply through adjustments to interest rates, bank reserve requirements, and the purchase and sale of government securities and foreign exchange. Governments influence the economy by changing the level and types of taxes, the extent and composition of spending, and the degree and form of borrowing.

Governments directly and indirectly influence the way resources are used in the economy. A basic equation of national income accounting that measures the output of an economy—or gross domestic product (GDP)—according to expenditures helps show how this happens:

$$GDP = C + I + G + NX.$$

On the left side is GDP—the value of all final goods and services produced in the economy. On the right side are the sources of aggregate spending or demand—private consumption (C), private investment (I), purchases of goods and services by the government (G), and exports minus imports (net exports, NX). This equation makes it evident that governments affect economic activity (GDP), controlling G directly and influencing C, I, and NX indirectly, through changes in taxes, transfers, and spending. Fiscal policy that increases aggregate demand directly through an increase in government spending is typically called expansionary or "loose." By contrast, fiscal policy is often considered contractionary or "tight" if it reduces demand via lower spending.

Besides providing goods and services like public safety, highways, or primary education, fiscal policy objectives vary. In the short term, governments may focus on macroeconomic *stabilization*—for example, expanding spending or cutting taxes to stimulate an ailing economy, or slashing spending or raising taxes to combat rising inflation or to help reduce external vulnerabilities. In the longer term, the aim may be to foster sustainable growth or reduce poverty with actions on the *supply side* to improve infrastructure or education. Although these objectives are broadly shared across countries, their relative importance differs, depending on country circumstances. In the short term, priorities may reflect the business cycle or response to a natural disaster or a spike in global food or fuel prices. In the longer term, the drivers can be development levels, demographics, or natural resource endowments. The desire to reduce poverty might lead a low-income country to tilt spending toward primary health care, whereas in an advanced economy, pension reforms might target looming long-term costs related to an aging population. In an oil-producing country, policymakers might aim to better align fiscal policy with broader macroeconomic developments by moderating procyclical spending—both by limiting bursts of spending when oil prices rise and by refraining from painful cuts when they drop.

The global crisis that had its roots in the 2007 meltdown in the U.S. mortgage market and global Covid pandemic crisis are a good case studies in fiscal policy. These crisis hurt economies around the globe, with financial sector difficulties and flagging confidence hitting private consumption, investment, and international trade (all of which affect output, GDP). Governments responded by trying to boost activity through two channels: automatic stabilizers and fiscal stimulus.

Stimulus may be difficult to design and implement effectively and difficult to reverse when conditions pick up. In many low-income and emerging market countries, however, institutional limitations and narrow tax bases mean stabilizers are relatively weak. Even in countries with larger stabilizers, there may be a pressing need to compensate for the loss of economic activity and compelling reasons to target the government's crisis response to those most directly in need.

The exact response ultimately depends on the fiscal space a government has available for new spending initiatives or tax cuts—that is, its access to additional financing at a reasonable cost or its ability to reorder its existing expenditures. Some governments were not in a position to respond with stimulus, because their potential creditors believed additional spending and borrowing would put too much pressure on inflation, foreign exchange reserves, or the exchange rate—or delay recovery by taking too many resources from the local private sector (also known as crowding out). Creditors may also have doubted some governments' ability to spend wisely, to reverse stimulus once put in place, or to address long-standing concerns with underlying structural weaknesses in public finances (such as chronically low tax revenues due to a poor tax structure or evasion, weak control over the finances of local governments or state-owned enterprises, or rising health costs and aging populations). For other governments, more severe financing constraints have necessitated spending cuts as revenues decline In countries with high inflation or external current account deficits, fiscal stimulus is likely to be ineffective, and even undesirable.

Similarly, the responsiveness and scope of stabilizers can be enhanced—for instance, by a more progressive tax system that taxes high-income households at a higher rate than lower-income households. Transfer payments can also be explicitly linked to economic conditions (for instance, unemployment rates or other labor market triggers). In some countries, fiscal rules aim to limit the growth of spending during boom times, when revenue growth—particularly from natural resources—is high and constraints seem less binding. Finally, medium-term frameworks with comprehensive coverage and assessment of revenues, expenditures, assets and liabilities, and risks help improve policymaking over the business cycle.

Fiscal deficits and public debt ratios (the ratio of debt to GDP) have expanded sharply in many countries because of the effects of the crisis on GDP and tax revenues as well as the cost of the fiscal response to the crisis. Support and guarantees to financial and industrial sectors have added to concerns about the financial health of governments. Many countries can afford to run moderate fiscal deficits for extended periods, with domestic and international financial markets and international and bilateral partners convinced of their ability to meet present and future obligations. Deficits that grow too large and linger too long may, however, undermine that confidence. Aware of these risks in the present crisis, the IMF in late 2008 and early 2009 called on governments to establish a four-pronged fiscal policy strategy to help ensure solvency: stimulus should not have permanent effects on deficits; medium-term frameworks should include commitment to fiscal correction once conditions improve; structural reforms should be identified and implemented to enhance growth; and countries facing medium- and long-term demographic pressures should firmly commit to clear strategies for health care and pension reform. Even as the worse effects of the crisis recede, fiscal challenges remain significant, particularly in advanced economies in Europe and North America and this strategy remains as valid as ever.

II. The Link Between Fiscal Policy and Inclusive Growth

The broader concept of inclusive growth encompasses dimensions such as equity, poverty reduction, and inclusion in the labor market. It emphasizes generation of productive employment and the accumulation of human capital over time, rather than solely direct short-term income redistribution, as a means of increasing incomes. Promoting inclusiveness means also that the government should provide a risk management mechanism to help individuals absorb risks to income or welfare that materialize and prevent vulnerability to shocks from becoming a constraint on productive, human-capital-seeking behaviors.

Fiscal policy could foster inclusive growth through its two components, namely expenditure and tax policies. In this section we look separately at the two components. In each case we lay down a conceptual framework and describe tools for redistribution. The discussion below draws mainly from the book on 'How to Achieve Inclusive Growth" published by Oxford University Press[3].

a) Fiscal Policy and Inclusiveness-Analytical Framework

Public spending is a powerful instrument to promote inclusive growth. Public spending can contribute to the

3 Oxford University Press: "How to Achieve Inclusive Growth" https://global.oup.com/academic/product/how-to-achieve-inclusive-growth-9780192846938?cc=zm&lang=en&

creation of opportunities in society through factor accumulation and productivity. It is also key in ensuring that individuals are ready and able to take advantage of the opportunities created by growth dynamics. To justify public action to achieve inclusive growth objectives (rather than relying on markets) and lay out the connections between public spending and inclusiveness, it is useful to examine the basics—the threefold rationale for fiscal policy proposed by Musgrave (1959). Under that framework, fiscal policy should aim at (i) promoting macroeconomic stabilization by focusing on countercyclical measures in the short term while preserving debt sustainability in the medium and long term; (ii) improving resource allocation by providing public goods in a cost-effective manner; and (iii) addressing distributional disparities and promoting equal opportunities.

According to Musgrave, fiscal policy aims at three objectives:[4]

i) **Promoting macroeconomic stabilization**. In the short run, the government can stabilize the economy by adding or withdrawing demand through its tax and spending powers. For example, during a recession, the government can increase unemployment benefits, send stimulus checks to households, undertake public works projects, or cut taxes, among other options. If the economy is overheating and inflation increases, the government can reduce spending and/or raise taxes. In the medium and long-term, macro stabilization requires preserving the sustainability of public debt and avoiding debt and financial crises.

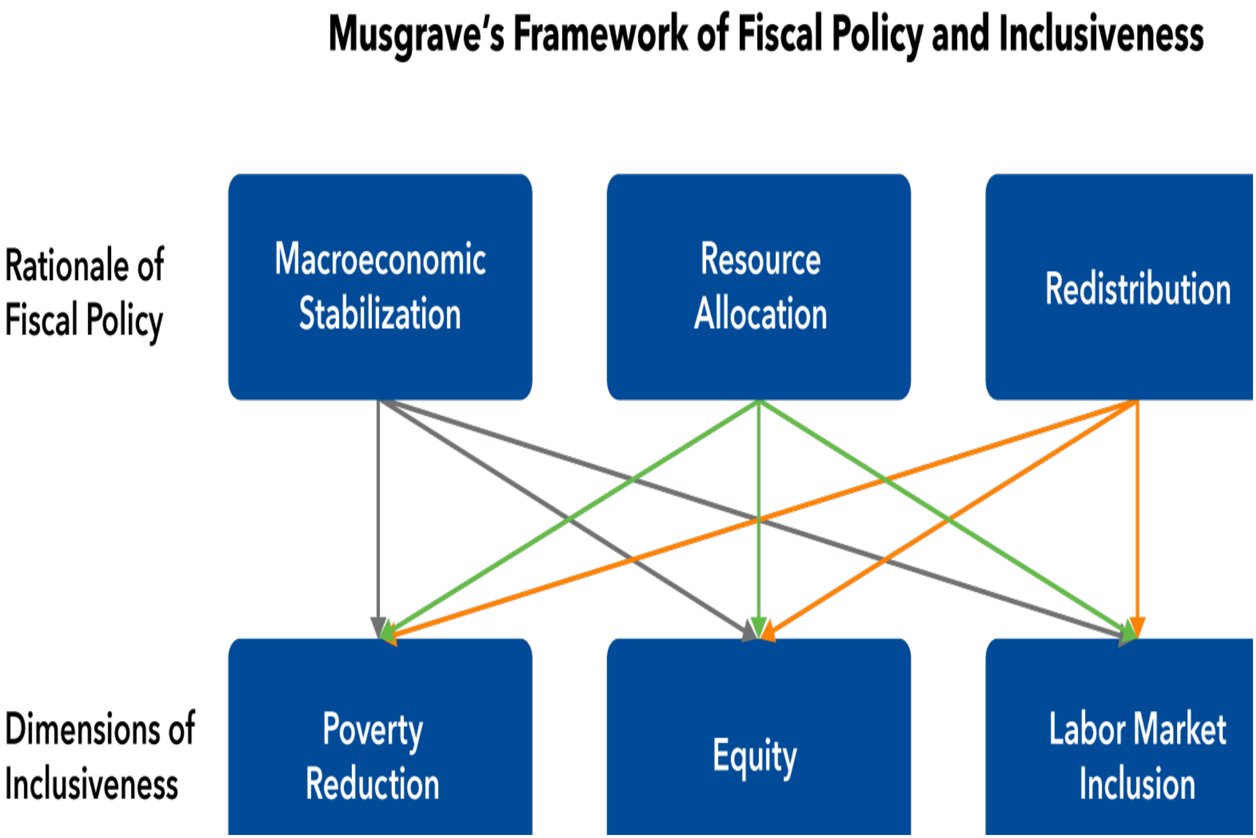
ii) **Improving resource allocation**. Fiscal policy can accomplish this by providing public goods in a cost-effective manner, and by creating conditions for a competitive and flexible private business sector.

iii) **Addressing distributional disparities while promoting equal opportunities**. Government spending on public services, social protection, and social insurance schemes, as well as taxes and subsidies have different impacts on various segments of society. Fiscal policy can thereby impact poverty, the distribution of income, and other aspects of inclusive growth.

All three elements of Musgrave's framework are shown in the figure 1 below:

4 Ibid pp 462-464

Figure 1: Musgrave's Framework of Fiscal Policy and Inclusiveness



When considering the distributional role of fiscal policy, the mix of expenditure and taxes matters. High tax progressivity is one way of redistributing income. Similarly, a country could reduce inequality with a relatively low level of tax progressivity if its expenditure policy is sufficiently redistributive. Ultimately, the appropriate mix of tax and expenditure policy depends on a country's social preferences for redistribution, on the nature and the relative sizes of the distortions (inefficiencies) created by both policies, and on the country's institutional capacity at enforcing tax and expenditure policies. Expenditure policy and tax policy therefore work together in promoting equity, growth, stability, and sustainability.

b) Classification of Fiscal Policy Measures [5]

Fiscal policy measures often entail tradeoffs between growth and equity. In an ideal world, all fiscal policy measures would promote growth and reduce inequality. unfortunately, this is not true in many instances. Often, measures supporting growth exacerbate inequality. Similarly, measures aiming at creating redistribution often slow growth, at least initially. The following provides a framework for classifying fiscal policy measures, depending on the impact they have on growth and equity.

i) In one extreme, there are win-win measures that can enhance long-term growth and labor market participation while reducing inequality. For example, expanding equal access to education will boost both growth and equity.

ii) At the other extreme, there are lose-lose policies that tend to generate inefficiencies and more inequality. Generalized energy subsidies are a good example of such policies as they tend to undermine economic growth and diversification and benefit disproportionally upper-income households.

iii) Across this efficiency-equity spectrum, there are growth-enhancing public spending measures that can make a significant contribution to growth and poverty reduction but with adverse effect on income distribution. Although, there are measures that can promote growth with no significant effect on income distribution.

iv) There are also redistributive spending measures that aim mainly at reducing inequality and poverty, but can also be good for growth, particularly when inequality is initially high. However, relying mainly on redistribution to reduce poverty and inequality can be a source of distortions and can crowd out resources for growth-enhancing spending policies. This may lead to lower growth and higher unemployment, and in some cases, to unsustainable fiscal deficits and macroeconomic instability, all of which undermine inclusiveness.

5 Ibid p. 464-465

v) Policies entailing an efficiency-equity trade-off should be complemented by mitigating measures. Achieving higher growth is crucial to reduce poverty. However, structural or fiscal measures that improve productivity and long-term growth can entail near-term burdens for some groups leading to higher inequality and greater wage dispersion. These anticipated negative distributional effects can be mitigated through the introduction or the scaling up of social protection such as well-targeted anti-poverty measures and social safety nets.

III. Fiscal Policy Tools for Enhancing Inclusiveness

1. Public Expenditure Policy Options for Enhancing Inclusive Growth

Public Expenditure Programmes accomplish the enhancement of inclusive growth through the following:

a. **Adequate social protection**: This provides social insurance and helps protect the most vulnerable through social assistance programs.

b. **Adequate spending on health and education**: This helps build productive **human capital**, while also contributing to enhancing social mobility and reducing inequality.

c. The provision of public goods such as **public infrastructure** helps improve social welfare and boost aggregate productivity.

a. Adequate Social Protection

Social protection is an important element of social welfare and represents a key pillar of the social contract. It helps individuals minimize the negative effects of shocks, natural disasters, and unfavorable life events and protect them from poverty and destitution. It also provides opportunities to build skills necessary to access jobs and return to the labor market. Social protection includes:[6]

6 GRGSRDC: Applied Knowledge Series:https://gsdrc.org/topic-guides/social-protection/types-of-social-protection

- **Social Safety net/Social assistance:** Social Safety net includes non-contributory transfers in cash, vouchers, or in-kind (including school feeding) to individuals or households in need; public works programmes; fee waivers (for basic health and education services); and subsidies (e.g. for food, fuel).

- **Social insurance**: Social Insurance are contributory schemes providing compensatory support in the event of contingencies such as illness, injury, disability, death of a spouse or parent, maternity/ paternity, unemployment, old age, and shocks affecting livestock/crops. There are various forms of social health insurance. 'National or social health insurance (SHI) is based on individuals' mandatory enrolment.' Voluntary mechanisms include private health insurance (PHI), which is implemented on a large scale in Brazil, Chile, Namibia and South Africa, and community-based health insurance (CBHI) in the Democratic Republic of the Congo, Ghana, Rwanda and Senegal There are ongoing efforts to increase the coverage of social insurance beyond the formal labour market to cover informal workers (the majority of the working-age population in most low- and middle-income countries) and other marginalised and vulnerable groups who have tended to be excluded from formal schemes. These efforts include:

    ✓ Non-contributory universal programmes – for example social pensions, universal health insurance and unemployment assistance, which are financed out of general taxation.

    ✓ Parallel schemes – for example, Tunisia has different pension programmes for public and private sector workers, while Mexico has separate contributory and non-contributory health insurance schemes with eligibility dependent on an individual's labour market status.

    ✓ Nationally integrated pensions with explicit subsidies – for example, Chile's pension system conclude that integrated social insurance systems combining 'an actuarially fair contributory system with explicit subsidies for the poor and informal seem to be more financially sustainable than universal non-contributory systems, and less distortionary than fragmented parallel schemes.'

✓ Some countries combine funding from contributions and taxation to achieve universal coverage. For example, in Mongolia self-employed and informal herders can elect to join the social insurance scheme to receive maternity cash benefits, on top of which the Social Welfare Scheme provides a maternity payment to all pregnant women and mothers of infants regardless of social insurance contributions, employment status, or nationality

- **Social care services**: Social care service are provided to those facing social risks such as violence, abuse, exploitation, discrimination and social exclusion. Social care and support is highly complementary to social protection, and is sometimes classified as social protection. Economically and socially vulnerable people have complex challenges. Providing the appropriate support requires direct outreach to assess challenges faced and required responses, which 'may range from psycho-social support to connections to needed services.' UNICEF considers 'outreach, case management and referral services integral to effective child sensitive social protection.' Such services 'allow the range of needs of families to be understood and families connected to relevant services, including those such as violence prevention that may fall out of the social protection sphere.

- **Labour market programmes:** Labour market policies and interventions provide protection for poor people who are able to work and aim to ensure basic standards and rights These government-led policies and interventions can be contributory or non-contributory, active (helping people acquire skills and connect them to labour markets), or passive (helping protect people against loss of income from unemployment, underemployment, diminishing real wages, and precarious and informal employment).

Active labour market policies and interventions aim to help the unemployed and the most vulnerable find jobs. Traditionally, this includes interventions such as: (i) matching jobseekers with current vacancies; (ii) upgrading and adapting jobseekers' skills; (iii) providing employment subsidies; and, (iv) creating jobs either through public sector employment or the provision of subsidies for private sector work. In high-income countries, such policies mostly extend to formal workers. In developing countries – with labour markets characterized by higher informality and lower unemployment than in higher-income countries – active labour market policies often include anti-poverty measures and blend interventions. For example, training programmes may be accompanied by public works and some type of income support, or employment subsidies may be aimed at hiring participants targeted by cash transfer programmes who are at risk of poor labour market outcomes such as underemployment and/or informality.

Passive labour market policies include legislation to underpin maternity benefits as well as wider rules regarding parental leave, injury compensation, early retirement incentives, and sickness benefits for those already in work, financed by the employer. Passive interventions also include changes to legislation, for example establishing a minimum wage or safe working conditions. These interventions are primarily aimed at those working in the formal sector. Many poor people work within the informal sector, particularly in developing countries, and some people with disabilities, the chronically ill, and the old may not be able to work at all, so labour market interventions cannot always reach them. There is an overlap in classifying passive labour market activities with social insurance mechanisms (e.g. unemployment insurance is an example of a passive labour market policy).

Figure 2 shows a taxonomy of social protection instruments, and Table 1 summarizes developments of an expanded nationally-owned social protection system in Kenya.

Figure 2: Taxonomy of social protection instruments

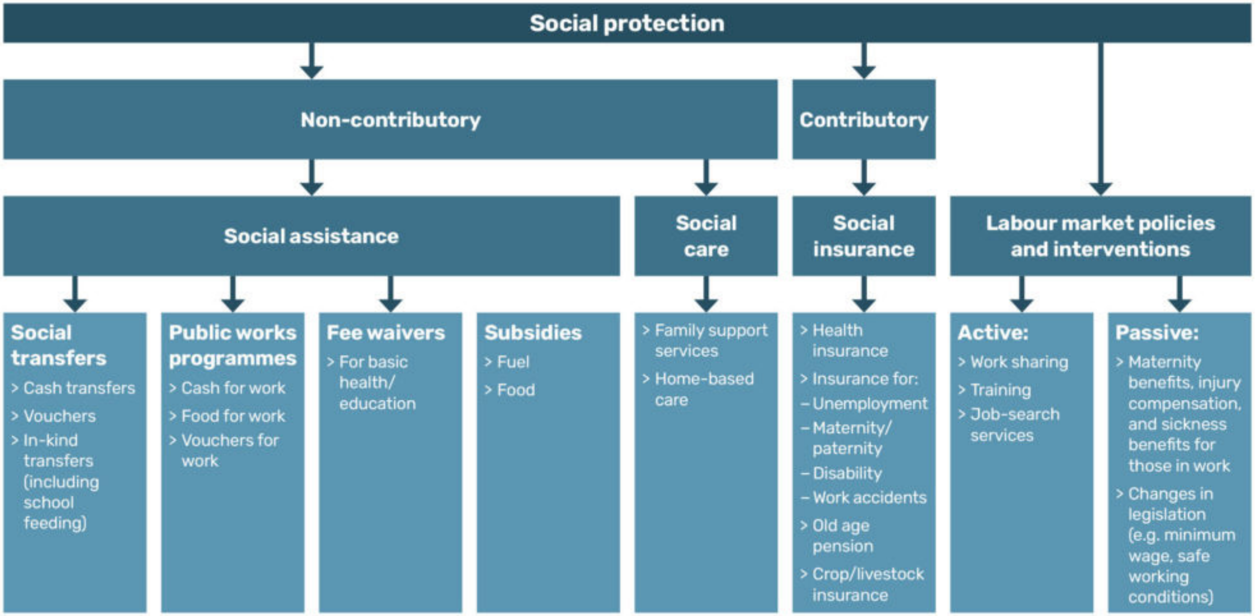


Table 1. Developments of an Expanded Nationally-Owned Social Protection System in Kenya[7]

7 UN: Global Research On Governance and Social Protection: Kenya Case Study https://www.developmentpathways.co.u`k/wp-content/uploads/2021/07/Kenya_SP-Governance-22ndJune.pdf

Kenya has made significant strides towards developing an expanded nationally-owned social protection system. In 2011/12, social protection funding was KES 4.3 billion (0.1 per cent of GDP) and this increased to a projected KES 29.9 billion in 2017/18 (amounting to 0.35 per cent of GDP). Notably, 72 per cent of this funding derived from the Government. Indeed, in the last decade, Kenya has begun to move from what Niño-Zarazúa et al (2012) have classified as a low income country (LIC) model of social protection – that is donor financed and focused on delivering programmes to the extreme poor – to a middle income country (MIC) model, such as what South Africa has in place, which is tax-financed, more based around the lifecycle, and influenced by European welfare systems. In 2013, the Government significantly expanded several poverty-targeted programmes, and consolidated them under the National Safety Net Programme, which is also known by the Swahili words "Inua Jamii". The latest addition to the Inua Jamii programme is the Inua Jamii Senior Citizens' scheme, which not only was Kenya's first universal programme, but also the first programme to be completely financed by the government. The scheme demonstrated the Kenyan Government's commitment to implementing a lifecycle social protection system. Indeed, the government is now examining the feasibility of designing a universal child benefit. For the social protection sector to expand, the Government has significantly strengthened its institutional arrangements.Institutional arrangements governing social protection are now much more harmonised. The State Department of Social Protection was established in 2015 and is currently located with the Ministry of Labour and Social Protection (MLSP). Within this Department are several units, including the National Social Protection Secretariat (SPS) – originally expanded in 2012 – which is responsible for coordinating social protection and developing policies for the Inua Jamii programme. The Social Assistance Unit (SAU) – first created in 2016 – is also located within the Department and oversees the implementation and delivery of the schemes within this programme. These changes, which consolidated the oversight and delivery of the OPCT (and, later the Inua Jamii Senior Citizens' Scheme), the Persons with Severe Disabilities Cash Transfer (PwSD-CT) and the Cash Transfer for Orphans and Vulnerable Children (CT-OVC) under the same Department, have brought much needed cohesion and coordination to the sector. Kenya's Enhanced Single Registry is a dynamic and innovative mechanism that has brought much needed harmonisation. The Single Registry – which was first launched in 2016 – consolidates the different Management Information Systems (MISs) of the OPCT (Inua Jamii Senior Citizens' Scheme), the PwSD-CT, the CT-OVC, HSNP and the World Food Programme's Cash for Assets. The Single Registry – along with the electronic MISs that link to it – has increased harmonisation and consolidation; provided a single platform in which common and essential information can be stored, accessed and analysed; helped prevent fraud; strengthened social protection sector planning and monitoring; and helped enable electronic payments to take place. The SPS is currently expanding the current Single Registry into an Enhanced Single Registry (ESR) with a social registry component. The means by which social protection benefits are paid has undergone a significant transformation and have increased accountability and provided recipients with more autonomy and choice. Notably, recipients of the Inua Jamii schemes are no longer paid manually, but through electronic means. Electronic payments are an essential aspect of good governance, as they increase transparency, improve traceability and real-time reconciliation, and reduce "leakage" and the number of "ghost" beneficiaries (through more stringent identification documentation). With the roll-out of the Inua Jamii Senior Citizens' Scheme, Kenya launched the "choice model" for payments. This was later also rolled out to the CT-OVC, PwSD-CT, and to those who had been on the OPCT before the Inua Jamii Senior Citizens' Scheme was implemented.

b. Adequate spending on health and education:

Education and health spending are two of the most important fiscal policy tools for addressing market income inequality. One key feature that distinguishes education and health policies from other redistributive fiscal instruments is that they have the potential to promote both growth and equity.

Education and health gaps are still sizable in many countries and closing them—through better allocation of public spending—would improve equity and efficiency by enhancing human capital and productivity. The following are the advantages of promoting health and education spending to prevent poverty and close gaps in coverage:[8]

- There is evidence that improved education outcomes (as measured by average years of schooling) have been associated with a significant decline in inequality of education outcomes (as measured by inequality in years of schooling), which, puts strong downward pressure on market income inequality The decline in market income inequality due to declining inequality of education outcomes between 1990 and 2005 ranged from 4.8 Gini points in the Middle East and North Africa to 2.8 points in Latin America and the Caribbean (Fiscal Monitor, 2017).

- In developing countries with low levels of education attainment, policies that promote equal access to basic education (for example, cash transfers aimed at encouraging better attendance at primary schools or spending on public education) could reduce inequality by facilitating the accumulation of human capital. This makes educational opportunities less dependent on socioeconomic circumstances.

- Extending public healthcare coverage helps limit out-of-pocket spending and reduce financial exposure to adverse health-related events, while freeing up household resources for other necessary spending. Although out-of-pocket spending has declined modestly in both advanced economies and developing countries, progress has been slow, and large gaps in healthcare coverage remain between the rich and the poor, especially in LICs and EMs.

- Public health spending also largely remains pro-rich in many countries as the rich typically use more healthcare services than the poor. Further conditioning the receipt of cash benefits on healthcare decisions made by the poor could be one effective way of reducing health disparities..

8 IMF On-line Training on “Fiscal Policy and Inclusive Growth

c. The Provision of Public Goods such as Public Infrastructure

Efficient public investment affects growth in the short and the long-term. During the implementation phase, public infrastructure investment boosts aggregate demand through the short-term fiscal multiplier. In the long-term, public investment impacts growth by expanding the productive capacity of the economy, enhancing the productivity of private investment and total factor productivity.

The impact of public infrastructure investment on inequality and poverty can be considerable in developing countries where the existing public capital stock is relatively low, and the existing infrastructure gap is large. This reflects unmet needs for basic goods and services such as transportation, clean water and sanitation, schools and hospitals.

Public investment expansions are associated with lower inequality among LICs. An exogenous increase in public investment of 1 percent of GDP was found to reduce the Gini coefficient by about 0.3 percent one year after the increase and about 2.3 percent five years after the increase (Fabrizio et al. 2017). The beneficial impact vanishes, however, when investment efficiency is poor. For OECD countries, larger public investment could increase growth without significant impact on inequality (OECD 2018). Public investment can play a central role to achieve inclusive growth. Preserving public investment and improving efficiency are key. The declining trend in public capital stock should be reversed to avoid adverse effects on long-term growth. This will require addressing the anti-investment bias by nesting the planning and the execution of public projects in the context of a medium-term expenditure framework that is consistent with fiscal sustainability. This will help also minimize problems arising from excessive political discretion[9]

Sound institutional processes, including better project appraisal and selection that identifies and targets infrastructure bottlenecks, and improved project execution should be in place to ensure productive and quality investment (IMF 2015). Improving public investment management would help also contain the fiscal cost and mitigate the trade-off between growth and debt. There is a need to scale up public investment on school and health infrastructure in order to expand access to education and healthcare services and address the social gaps. Investment strategies should cover areas that enable the largest possible number of poor people to engage in

9 Oxford University Press: "How to Achieve Inclusive Growth" https://global.oup.com/academic/product/how-to-achieve-inclusive-growth-9780192846938?cc=zm&lang=en&p.484

productive activities and access social services. Priorities could focus on: (i) expanding the road network especially in underserved areas; (ii) improving access to water and sanitation; (iii) preserving access to affordable energy services through subsidies targeted to poor households; (iv) ensuring an equal access to affordable Internet in order to reduce the digital divide between rural and urban areas and between low- and upper income households; (v) expanding fair access to E-government services; and (vi) supporting the adoption by smaller firms of new technologies[10]

d. Role of Budget Institutions[11]

Weak budgetary institutions hamper economic development and limit equal opportunity. Decisions about public spending and redistribution are ultimately determined through a political process (Musgrave 1959). Weak public institutions will more likely lead to a failure to incentivize government and government officials to allocate resources towards achieving inclusive growth. There is no shortage of anecdotal evidence of how the politically connected capture the policy process to acquire rents and tilt the policies and rules in their favour. By contrast, good budget institutions reduce political discretion and help contain the spending bias. They are also conducive of more efficiency and reinforce the counter-cyclical feature of public spending, reflecting prudent policies during good times that allow to build fiscal buffers for the bad times. This, in turn, will help limit the severity of recessions and their impact on the population and speed up recoveries. A 2014 IMF analysis of policy responses to the 2009 global crisis among G20 countries found that strong budget institutions are associated with more timely fiscal policy response, reflecting notably the ability of governments to quickly identify and understand the economic challenges (IMF 2014a). Another key finding is that countries with weak budget institutions fail to protect public investment during fiscal consolidation episodes. Moreover, strong institutions lead to more stable and predictable investment flows. The following are policy actions which are needed to strengthen budget institutions:

- **Strengthening public financial management** This can reduce rent-seeking, improve efficiency of public spending and lead to more inclusion. Improvements in public financial management (proxied by PEFA scores) are associated with declining inequality in developing

10 Ibid p.484

11 Ibid 484-487

countries (Zouhar et al. 2021). For OECD countries, Fournier and Johansson (2016) found that greater government effectiveness may reduce inequality, as a result of better targeting of disadvantaged groups and more cost-efficient delivery of transfer programs. Strategies to strengthen budgetary institutions need to focus on enhancing fiscal transparency, enforcing expenditure controls, strengthening accountability and audit, and improving governance of state-owned enterprises. Priorities could also include

- **Enacting fiscal responsibility laws**: This encompasses the agreed-on set of policies, processes, or arrangements intended to improve fiscal outcomes, discipline, transparency, and accountability by requiring governments to commit to fiscal policy objectives and strategies that can be monitored. Adopting fiscal responsibility laws are beneficial in many ways. It helps smoothing out fiscal policy over time by taking into account longer-term considerations; as such a fiscally responsible government will not resort to policies which may put an excessive burden on future generations. Fiscal responsibility reinforces macroeconomic stability and growth as fiscally disciplined governments tend to implement sound fiscal policies and are in a better position to react to unexpected events. Governments can also better focus on designing efficient spending and implementing strategic priorities as they spend less time to worry about how to make the ends meet (peace of mind).

- **Improving public procurement procedures**. Given the large funds involved, procurement is potentially vulnerable to fraud and corruption. It can also alter fair competition and equal opportunities to companies as it can be captured by politically connected firms. Promoting transparent bidding processes and competitive procurement should improve efficiency (value-for-money) and effectiveness.

- **Operationalizing medium-term budgeting**. Understanding the future implications of current policy decisions on fiscal sustainability requires a multi-year budget framework. However, to be effective, multi-year budget frameworks need to be consistently articulated with the annual budget and well embedded in the decision-making process (not just an accounting exercise). By emphasizing a strategic perspective, medium-term budgeting allows to align inclusive growth objectives with resource allocation over time (OECD 2011). It also helps enforce fiscal discipline and reduce the deficit bias. Moreover, a credible medium-term fiscal framework anchors investor confidence and preserve government access to financial markets during downturns, which helps curb pro-cyclical pressures. The transition from a line-item budgeting to program budgeting would increase accountability and reinforce the link between resources and outcomes.

- **Involving citizens**, in the budget process. There are plenty of examples of politicians using public spending for their own political gains, including by providing benefits to their favored groups. Giving citizens a say in the design and implementation of the budget can support inclusiveness by improving the quality of the service delivery and ensuring more accountability. For example, de Renzio and Wehner (2015) shows that greater citizen participation and budget openness can help tackle leakage and corruption and improve public resource allocation by ensuring that the selection of public programs takes into account the needs and preferences of the most disadvantaged. Conducting incidence analysis of fiscal policy options can better inform policy choices and the design of mitigating measures to protect the vulnerable and those adversely impacted by reforms. For example, Spain conducts impact assessments of policies and regulations on gender and regional distribution (OECD 2011). Some countries, such as the United Kingdom and New Zealand, require a distributional analysis of the public projects, in which, at a minimum, appraisers quantify how project costs and benefits accrue to different socioeconomic groups.

2. Tax Policy Options for Enhancing Inclusive Growth

Taxation is at the heart of the inclusive growth debate: Taxes affect employment and investment and empirical studies find that taxes have important implications for economic growth. Taxes also affect poverty as well as income and wealth inequality—in other words, 'Inclusiveness is reflected mainly in the progressivity of the tax system—a tax burden that rises with a taxpayer's income or wealth. It also refers to other dimensions of equality, such as equal treatment by gender, equality of opportunity, intergenerational equity, as well as treating people in similar circumstances the same (horizontal equity).

Economic literature shows that there is an often tradeoff between tax policies that foster growth and tax policies that reduce income inequality (i.e. nurture inclusiveness). The literature also shows that both the level and composition of taxes matter for inclusive growth.

There are different channels through which taxes can reduce income inequality[12].

- **Directly:** certain taxes can be used by the government as an instrument for redistribution from the 'Haves' to the 'Have-Nots.' For example, higher tax rates on wealthy households would likely increase progressivity of tax system—helping reduce inequality.

- **Indirectly:** Indirectly: tax revenues are also necessary to fund fiscal spending that promotes equity. This makes it increasingly important to assess combined effect of taxation and spending together.

- **Taxing "Negative Externalities:** By taxing "negative externalities": Activities with harmful social consequences (e.g. pollution and environmental degradation resulting in climate change) could harm the poor disproportionally. For example, people living in slums or in more densely populated and highly polluted areas are more likely to develop health issues. Some revenue instruments could curb such activities.

- **Enhancing Revenue Administration:** Too many procedures and complex tax systems may encourage informal activities and less inclusion of disadvantaged groups. Streamlining tax administration can have a positive impact on those group, hence fostering inclusion.

In the following we will elaborate on tax policy principles for inclusive growth and designing tax policy for inclusive growth.

a. Tax Policy Principles for Inclusive Growth[13]

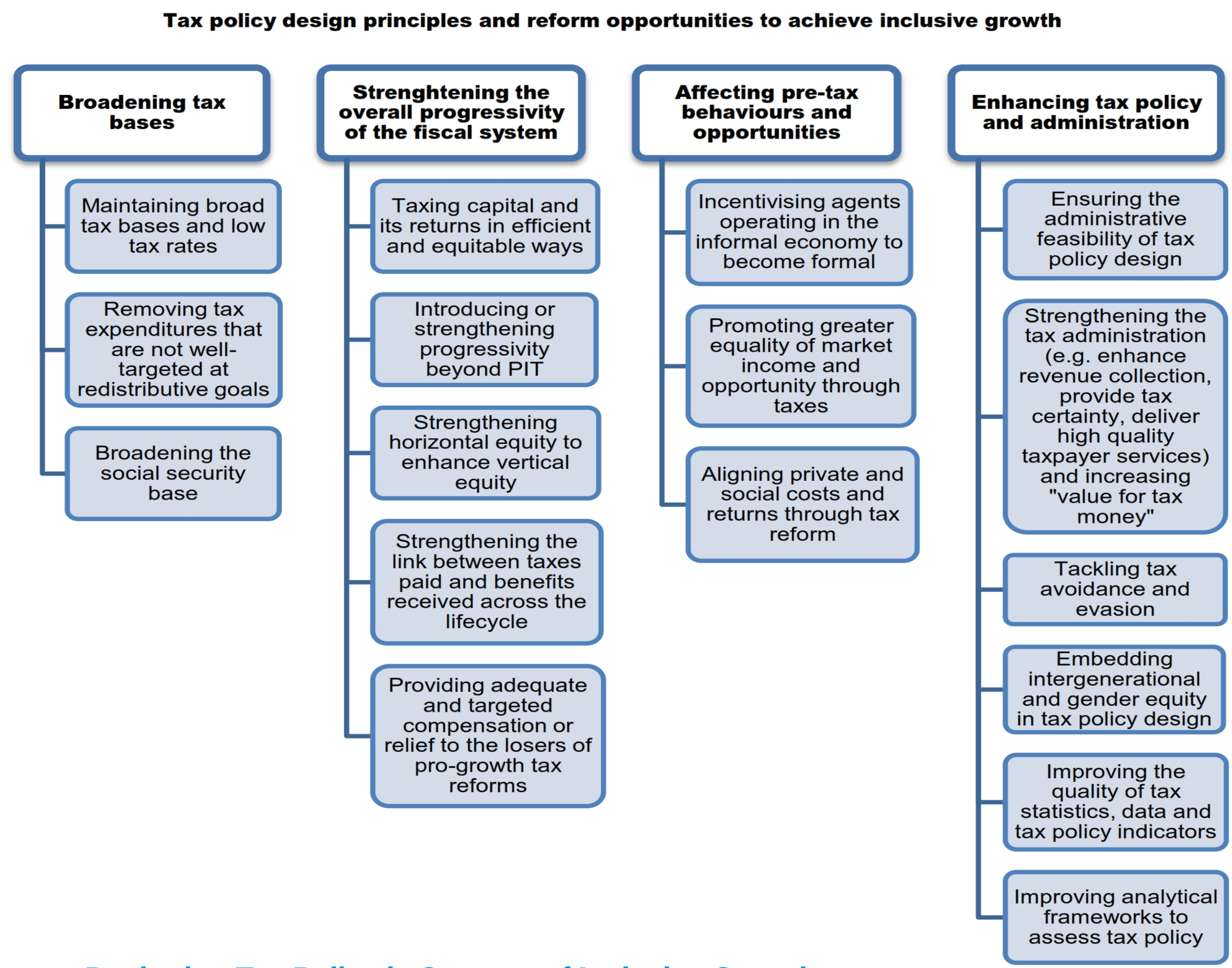
The principles are grouped under four broad pillars and presented in figure 2, Below. The pillars are: (1) broadening tax bases; (2) strengthening the overall progressivity of the fiscal system; (3) affecting pre-tax behaviours and opportunities; and (4) enhancing tax policy and administration. Tax design for inclusive growth depends on a variety of country-specific factors, which means that there is no "one-

12 IMF. On-line training on Inclusive Growth

13 Brys B, Perret S.' Thomas A, O ReillyP, "Tax Design for Inclusive . Economic Growth". OECD Taxation Working Paper No. 26, p.50

size fits-all" approach.

Figure 3. Tax Policy Design Principles and Reform Opportunities to achieve Inclusive Growth



b. Designing Tax Policy in Support of Inclusive Growth

Key tax policies in support of inclusive growth. Include, the following among others:[14]

i) Taxation of labour income;
ii) Corporate Income Tax;
iii) Wealth Tax; and
iv) Consumption tax such as VAT and excise tax.

(i) Taxation of Labour Income

In advanced economies, the personal income tax (PIT) raises around 10 percent of GDP. In developing countries, this is much lower, generally not more than 3 percent of GDP. Moreover, these PIT liabilities in developing countries come from a small portion of the population, often comprising of salaried employees in the public sector. The main challenge for these countries is to expand the scope of the PIT system by increasing compliance. In all countries, designing an efficient, equitable and enforceable PIT system requires considering the following aspects:

- **Use individual income as the tax unit**: The unit of income taxation can be either family or individual income. Many advanced economies have transformed their PIT into an individualized system. Fully individualized PIT systems are now in place in most European countries following initial reforms in the 1970s and 1980s in Scandinavia, Austria, the Netherlands and in 1990 in the U.K. Countries have also introduced other features to improve the labor market participation of secondary earners, such as tax credits or deductions for childcare expenses or targeted deductions for the income of secondary earners.

- **Choose an appropriate PIT threshold**: A threshold—either in the form of a zero-tax bracket, a basic deduction or a general tax credit—supports tax progression by reducing or eliminating the tax burden on people with the lowest incomes. Thresholds vary significantly across economies. In the OECD, the median is approximately 25 percent of the average wage. Several emerging and developing economies, however, have no threshold at all and introducing one could relieve the poorest households from the obligation to pay tax and ease administration. However, the threshold should not be too high either, as this can lead to greatly reduced revenues.

14 Abdel-Kader K, and De Mooij, "Tax Policy and Inclusive Growth" IMF Working Paper WP/20/271, Dec. 2020, pp.16-26

- **Provide relief for low-income wage earners**: Optimal income tax theory provides a rationale for subsidizing earnings of low-wage workers, both because they are relatively responsive to tax (so that relief will eliminate severe inefficiencies) and because it contributes to reducing inequality. In many advanced economies, these take the form of refundable tax credits, which constitute a net transfer to the individual when they exceed income tax liabilities. These benefits increase the net income gain from accepting a job relative to the alternative of being out of work and provide income support. In-work benefits are usually phased out as incomes rise, with the steepness of phase-out depending on the primary objective of the program. In countries that emphasize the labor force participation objective, benefits are usually gradually phased out with individual income (Belgium, Finland, Germany, the Netherlands, and Sweden). In countries that emphasize the income support objective, benefits are often conditional on the presence of children in the household and generally phased out more steeply with family income so as to prevent leakage of benefits to higher income families and reduce fiscal costs (Canada, France, Korea, New Zealand, the Slovak Republic, the United Kingdom, and the United States). In the U.S. in 2017, 27 million eligible workers and families nationwide received about $65 billion in tax credits under the earned income tax credit. The federal government estimates that it lifted 9.4 million people out of poverty, including 5 million children.

- **Rationalize tax deductions:** Many countries—including developing ones—adopt various tax allowances in the PIT related to children, education, housing, health insurance, commuting and charitable donations. Some accrue disproportionately to the rich, such as deductions for mortgage interest, because households with high incomes are more often homeowners. Rationalizing mortgage interest deductibility could complement steps towards a more progressive tax system and improve efficiency, since these deductions create their own distortions. More generally, PIT tax expenditures (defined as specific provisions in the tax code that allow certain people or companies to pay less tax) in several countries accrue disproportionally to people with high incomes.

(ii) Corporate Income Tax (CIT)

- **Use Cost-based Rather Than Profit-based Tax Incentives:** Most countries use some form of tax incentives to mitigate the distortionary impact of the CIT on investment. In advanced economies, especially investments in research and development (R&D) are incentivized. In developing countries, incentives often focus on attracting foreign direct investment (FDI). For both, their design can often be improved by focusing the incentives on reducing the cost of investment, rather than on providing tax relief on profits. However, these incentives are generally found to be ineffective and inefficient. Indeed, their fiscal cost can be high, while surveys show that these tax incentives generally rank low in the list of relevant location factors for multinationals. Surveys also indicate that profit-based tax incentives are often redundant—that is, the investment would have been undertaken also without them. Investment tax incentives that directly reduce the cost of investment, such as investment tax credits, accelerated depreciation or outright expensing of investment yield more investment per dollar spent. The governance and management of tax incentives can be improved by relying on objective rules-based criteria embedded in the tax law, as opposed to discretionary granting on a case-by-case basis.

- **Adopt tailored anti-tax avoidance measures** A major risk for the CIT base of countries is due to profit shifting by multinational companies. For instance, international businesses can use transfer pricing techniques, international debt shifting and treaty shopping to reduce their tax liability in a country. To protect the CIT base against profit shifting, it is important for countries to adopt appropriate anti-tax avoidance measures. The OECD project on base erosion and profit shifting (BEPS) agreed upon common rules and guidance for countries to do so. The European Union has adopted two Anti-Tax Avoidance Directives, to make some of these outcomes mandatory for its member states. In the US, the Tax Cuts and Jobs Act contains anti-tax avoidance provisions that go beyond the BEPS standards by introducing minimum taxes on outbound and inbound investment. In developing countries, anti-tax avoidance measures are particularly important, as these countries suffer relatively more from profit shifting than advanced economies The capacity to enforce anti-avoidance measures in these countries is constrained, however, due to limited administrative capacity. Moreover, developing countries face distinct problems associated with taxing income at source. To address profit shifting and strengthen the revenue base, developing countries require tailored solutions for instance in the form of simple caps on CIT deductions to foreign related companies or the adoption of alternative minimum taxes, imposed on assets, turnover or cash-flow.

- **Avoid Special Tax Incentives for Small and Medium-sized Enterprises (SMEs)**: Such incentives include reduced CIT rates or size-related tax deductions. They run the risk of discouraging firm growth and may end up benefiting wealthy entrepreneurs who own multiple businesses (thus undermining progressivity). They consume considerable administrative effort.

(iii) Wealth Tax

In designing wealth taxes, countries can consider the following guidance, namely: i) Exploit Recurrent real Property Taxes fully; ii) Impose Estate or Inheritance/Gift Tax.[15]

- **Exploit Recurrent Real Property Taxes:** Such taxes are imposed on gross property values and are found to be among the least distortive for economic growth, likely as their base is immobile and current rates are low.

Given that they are paid mainly by residents, and property values reflect the value of local public services, property taxes can resemble a benefit tax. This can also support accountability of local authorities.

Property taxes are capitalized into house prices and can be progressive since home values generally increase with income and net total wealth holdings.

In many countries, recurrent property taxes have been underutilized. In advanced economies, their average yield is around 1 percent of GDP—although the UK and the US generate close to 3 percent of GDP. In developing economies, the average yield is less than ½ percent of GDP.

In many countries, there is scope to exploit property tax more fully by:

- ✓ Raising tax rates.
- ✓ Updating property values to current market prices. Market-based valuation is hard, but simplified approaches based on property areas can produce reasonable outcomes at lower

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administrative costs.

- ✓ improving cadasters and scaling up administrative capacity, especially in developing countries.

- **Impose Estate or Inheritance/Gift Taxes:** These taxes can be effective redistributive tools to limit inter-generational wealth inequality and enhance equality of opportunity—an important dimension of inclusiveness.

Although most advanced economies impose them, these taxes have not proved easy to implement due to ample tax exemptions, high thresholds, and widespread avoidance and evasion.

The average revenue in countries that have such a tax is 0.1 percent of GDP in 2017. However, revenues are higher in Belgium and France (up to 0.7 percent of GDP), suggesting that improvement is feasible.

(iv) Consumption Taxes

Consumption taxes are generally less progressive than taxes on income or wealth and might sometimes be regressive. It is difficult to make consumption taxes progressive because governments usually cannot observe individual purchases. Attempts to make consumption taxes more progressive are therefore blunter and less efficient than designing progressivity in income and wealth taxes. Consumption taxes are a major revenue source for most governments, in part due to their relative ease of enforcement and collection. If the revenue is used for progressive spending, the net impact on the poor can still be positive.

To support inclusive growth, the following considerations are important for consumption taxes.

- **Design an Efficient VAT:** Today, more than 160 countries have a VAT system in place, which resembles a broad-based consumption tax. These systems typically account for around one-quarter or more of total tax revenue. A VAT is imposed on every transaction in the production process. When goods are purchased by a VAT registered business, the tax paid on inputs is credited or refunded. This ensures that VAT is ultimately only levied on final consumption, where no credits or refunds are provided. This design has the attraction of encouraging voluntary tax compliance, since each business has an incentive to register in order to claim credits on their inputs. Moreover, those who operate in the informal sector are still charged on their inputs, without them being able to claim credits. Nevertheless, VAT design in many countries can be full of exemptions and differential rates, which reduces these advantages and induces economic distortions. Acosta Ormaechea and Morozumi (2019) find that this can be damaging for economic growth. To effectively raise revenue from VAT while doing the least damage to inclusive growth, VAT systems can best be designed with a high threshold, a broad base, and a single rate.

> A sufficiently high threshold aims to reduce the compliance costs of VAT for small traders. At the same time, the revenue foregone can be minimal, in part because unregistered businesses cannot claim input credits. A VAT threshold can also strengthen the progressivity of the VAT by reducing the tax on small traders in rural areas.. Some countries exempt basic goods from VAT to mitigate its distributional effects. However, exemptions are inefficient to achieve a more equitable outcome. First, they cause distortions due to cascading effects (tax on tax) if applied to intermediate stages of the supply chain, as exempt businesses cannot claim credits on their inputs. Second, exemptions create a bias against outsourcing by businesses, since the tax burden can be reduced by producing inputs in-house rather than purchasing taxable inputs from third parties. This creates another inefficiency. Third, by exempting suppliers, the incentives for voluntary compliance with the VAT are reduced. A limited number of well-defined exemptions is quite common, however, for practical reasons. Standard exemptions are applied for example for margin-based financial services, basic health care and education. Use a single VAT rate. Some countries tax necessities such as food and medicine at special reduced VAT rates to pursue redistributive policies. The idea is that the poor spend a large proportion of their income on them so that a reduced or even zero rate offers relief. However, this policy is inferior to pursuing redistribution through other tax and spending policies since it is poorly targeted. For instance, as the rich spend a larger absolute amount on such goods, a large portion of the benefits from a reduced rate accrue to them. Moreover, differential rates significantly complicate VAT administration and cause complexity in defining what goods precisely fall under the reduced rate. Spending measures, such as transfers in cash or in kind, are considerably more efficient to achieve distributional objectives than reduced VAT rates. In developing countries, where the

availability of these spending instruments is less common, some reduced VAT rates can be justified on equity grounds—albeit at a high revenue cost.

- **Impose Environmental Taxes:** A key efficiency reason for differential consumption taxation is due to externalities. They arise if the consumption of a good affects the wellbeing of those not involved in the underlying transaction. Environmental damage, such as climate change, is the leading example of a negative externality. The corrective tax, also called a Pigouvian tax, is designed to internalize the external cost of a transaction in the price (i.e. "setting the price right") so that agents change their behavior in the desired direction, e.g. by reducing pollution. Pigouvian taxes generally come on top of broad-based consumption taxes and should be imposed per unit of consumption, at a level directly related to the external costs—such as the social cost of carbon emissions in the case of climate externalities. As environmental taxes can be regressive, their introduction may require offsetting tax or spending measures to compensate poor households. In advanced economies, environmental taxes (including on energy) raise around 1.5 percent of GDP in revenue; in developing countries this is usually lower. In many countries, there is significant potential for these taxes to yield more revenue while also improving environmental quality. For example, in the EU, environmental taxes raise around 2.5 percent of GDP. This seems to have had no negative impact on economic growth. For instance, a recent study by Metcalf and Stock (2020) finds no evidence for negative growth effects of carbon taxes in Europe. A carbon tax of $75 per ton, necessary to meet the Paris climate objectives, has been estimated to yield more than 1.5 percent of GDP in G20 countries.

- **Use Specific Excises:** Excises on alcohol, tobacco and unhealthy food ('sin goods') are generally motivated by related social concerns—although not strictly speaking externalities. Bounded rationality of households and lack of self-control may justify government intervention in the pricing of these addictive commodities—although such arguments are not undisputed. Most countries use excises on these products as part of their policy to improve health outcomes, but revenue raising objectives are important as well. For developing countries, these excises can have special appeal as concentrated production and high import shares make administration relatively easy. Revenue from excises (including on fuel products) varies from an average of 1 percent of GDP in low-income countries to around 2.5 percent of GDP in advanced economies. Over time, revenue has often declined in several countries due to a lack of indexation of the specific (i.e. per unit) rates, which causes revenue to fall with inflation. In many countries, there is scope to raise significantly more revenue from excises without adverse distributional effects (Cnossen 2020). Indeed, while excises tend to bear relatively more heavily on people with low incomes, this only holds in advanced economies and not for developing countries. Special excises on luxury goods, such as yachts, jewelry or perfumes usually contribute little to achieving equity objectives, raise little revenue, and add to administrative costs. The exception is excises on motor vehicles, which can raise sizable amounts and are generally progressive.

IV. Conclusions

In this paper we explained how fiscal policy could be used to make growth more inclusive. The following are key conclusions among others:

a) Fiscal policy cannot be inclusive unless it leads to macroeconomic stability and fiscal sustainability.

b) Public expenditure is the most powerful instrument at hands of governments to achieve their objectives of economic development and social welfare. The central role of public expenditure has been further ascertained by the global Covid-19 pandemic crisis in view of the widespread and massive rolling out of spending measures to scale up health capacities, protect the population and support businesses. Public expenditure policy is shaped by country-specific circumstances such as the country's preferences with respect to the role of the government, the country's development level, its available fiscal space, and the government's ability to raise taxes. Public expenditure programs contribute for inclusive growth, through three channels: social protection, human capital formation, and investment in public infrastructure.

c) Understanding the trade-offs and complementarities of fiscal measures with regard to inclusiveness is key. Many areas of public spending offer possibilities to achieve both efficiency and equity. Examples of win-win measures include expanding equal access to education and promoting access to maternal health services. Other measures (e.g., subsidy reform), however, involve tradeoffs that cannot be systematically avoided, and would require mitigating measures. The right policy choices require assessing the incidence on different population groups, particularly the poor. The "right" package of spending measures should be cost-effective, consistent with fiscal sustainability and take into account country specific circumstances.

d) Strengthening the institutions and governance is necessary to improve the quality of spending and its efficiency. Some measures that can be considered cover the areas of public financial management, procurement, and fiscal transparency laws. It is also important to improve fiscal transparency and ensure a better involvement of the civil society throughout the different stages of the budget process. Equally important are the establishment of effective independent audit institutions and anti-corruption agencies.

e) Taxes affect inequality or 'inclusiveness,' mainly through the progressivity of the tax system—meaning a tax burden that rises with a taxpayer's income or wealth—and affecting other dimensions of equality, such as equal treatment by gender, equality of opportunity, intergenerational equity and by treating people in similar circumstances the same.

f) Many developing countries have scope to promote inclusive growth through among others the following tax reforms:

- i) Continue to build their administrative capacity to better enforce existing taxes.
- ii) Improve and simplify their VAT and excises,
- iii) Protect their income taxes better against avoidance and evasion,
- iv) Taxes may be progressive, but if transfers to the poor are not large enough, they may worsen poverty
- v) Reduce discretionary tax incentives,
- vi) Enhance fiscal regimes for extractive industries, and better exploit taxes on property and pollution.
- g) Addressing political, and social challenges, focusing on net redistributive impact of fiscal policy, mitigating the impact of fiscal reforms on inclusive growth, and addressing institutional

challenges. Ensuring strong political commitment and leadership include the following among others[16]:

i) Building consensus. Consultative discussions might not create unanimous support, but will instill in society a sense of country wide ownership.
ii) Garnering public support.
iii) Building coalition in support of change, while addressing opponent's concerns about it's distributional impact.
iv) Developing clear and broad communication strategy.

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