

*Fiscal Space for Human Development

UNMIT
November 2012



*“Fiscal space is the financing that is available to government as a result of concrete policy actions for enhancing resource mobilization, ..., for a specified set of development objectives.”

*(Rathin Roy, UNDP 2007)

* **How to define Fiscal Space?**

Fiscal Space. We, at UN, particularly talking on Human Development and for the achievement of Millennium Development Goals, that the government of Timor Leste signed and meticulously monitors and follows up, consider fiscal space as the financing that it is available to the government as the result of concrete political actions for a better resources mobilization aiming to development objectives.

This is not a static of fixed concept, since involves concrete actions to secure the enabling governance, as well institutional and economic environment to make development goals effective.

*The traditional public finance approach (WC)

- *short-term fiscal solvency and macroeconomic stability considerations
- *ensure that expanding fiscal expenditures does not harm fiscal solvency and macroeconomic stability in the short-term

*The UNDP Approach

- *the long term benefits of securing human development outcomes , need to be weighed against fiscal sustainability and macro stability considerations
- *Relax requirements in the short run to achieve long term fiscal sustainability

*The difference in approaches

In the IMF's approach, short-term **fiscal solvency and macroeconomic stability considerations** are primary considerations that determine the possibility of mobilizing additional resources for development.

In UNDP's approach, the long term benefits of securing **human development outcomes (such as the MDGs)** are the primary considerations, which need to be weighed against fiscal sustainability and macro stability considerations.

- In the IMF's approach, the emphasis is to ensure that expanding fiscal expenditures does not harm fiscal solvency and macroeconomic stability in the **short-term**.

UNDP's approach calls for a need **to consider the long term impact** on fiscal sustainability and macro stability, and **to relax fiscal requirements in the short term**.

*It is therefore seen as vital to look at the *dynamic long-term impact* of fiscal expansion on growth and development in order to assess the sustainability of spending

*The challenge: A dynamic approach

With these in mind, the additional challenge is to have a dynamic approach on the impact of fiscal expansion in terms of economic growth and human development, to assess the sustainability of the spending.

Trickle down is not enough

Short and long term impacts on:

- Economic growth

- Human development

- MDG achievement

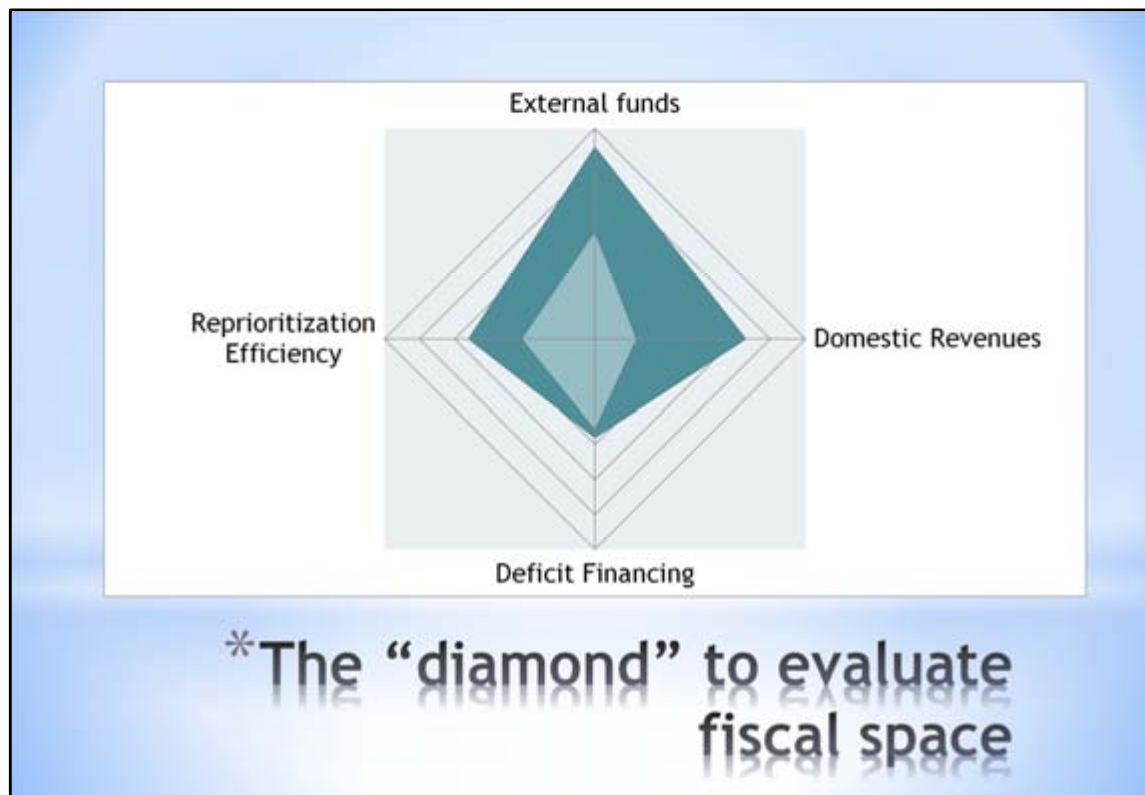
- This implies the analysis of crowding in and out

- Income distribution

- Spill over effects

- Synergies among interventions.

- Integral interventions



UNDP developed this “diamond” graph to evaluate the Fiscal Space. It is constituted by four axes in terms of % of GDP. Those axes are:

1. External funds or external support
It is constituted by the resources that the country can get from Development Aid, or other external sources. Here the question is how sustainable are the foreign sources of financing. For how long and at what pace the donors will support the country? To what extent the country can contract debt? When that is going to be turned into an expenditure?
2. Domestic resource mobilization.
This is basically the tax collection. Who should be taxed? Which is the impact on the rest of the economy? Should/can tax/GDP ratio be increased? If so, how can this be done while ensuring that the burden on the poor is minimized?
Should VAT be introduced if absent?
3. deficit financing;
This includes borrowing from domestic and foreign sources.
What are the needs for public investment?
What is the case/room for additional borrowing in relation to point/pillar 1?
What is the level of internal and external debt?
Access to international capital market?
What is the level of investments and savings? To what extent do the savings contribute to investments?
If savings are low, why? How to reduce obstacles to savings? How to improve channelling of savings for public investment?
4. reprioritising expenditure or increasing its efficiency
This includes those interventions that could be reprioritised in order to achieve some quantitative indicators, such as the ones of MDGs
What is the ratio of current/capital expenditures?
What is the share of expenditures that can be classified as pro-poor?
To what extent can the government enhance the value for money for goods and services it provides?



Obviously the case of Timor-Leste nowadays is special. The existence of the Petroleum Fund and the royalties provided from it, are similar to foreign aid. The country took a very wise decision of preserving part of the fund, due to its non-renewable nature, to preserve part of it for future generations. Today we are talking of 8.9 billion dollars that are an asset of the Timorese people. But also it is the commitment that we mentioned at the beginning with the present generation, with those that fought to make this country what it is now. We can see that external funds account for the big bulk of the fiscal space, while domestic revenues and the deficit financing via debt, are a minor part. The challenge is for next year, to expand the fiscal space by increasing domestic resources by means of cost recuperation of the infrastructure such as electricity, increasing tax collection as a matter of principles, especially from the richest segments of the population, and the reprioritization and efficiency gains in the social dimension, taking advantage of the large infrastructure investment for the people.

- *Tax collection as a tool for:
 - *Local resources mobilization
 - *Income distribution levelling
 - *Develop citizenship and fiscal responsibility

*The domestic front...

In this respect I would like to draw your attention to an issue that it is not sufficiently discussed, and it is tax collection. There is a wrong believe that capitalists do not invest if taxes are high or if labor costs are high. If this would be true, Germany or Japan would be in the bottom of the ranking. Capitalist invest wherever they see profits, that is why the development of the domestic market is so important and will help to improve the efficiency of the investment.

Tax collection is not only a source of income for the government, it is an essential part of the role of the state in order to mobilize local resources from richer to poorer areas, from richer income groups to those that need improved services. It is a tool for levelling income distribution, that as was said, is crucial in the process of providing efficiency to the economic growth in relation to poverty reduction.

But tax collection also has some other important institutional effects. It is a way of developing fiscal responsibility and appropriation of the process, since citizens feel that the government delivers goods and services based in the taxes paid by the population.

- *Improve efficiency
- *Evaluation of the impact of interventions
- *Depth vs. coverage
- *Cost benefit analysis of infrastructure
- *Cost benefit of contracting debt

*The agenda...

The analysis of the fiscal space has many side benefits, since provides a technical backup to political decisions, bearing in mind the non neutrality of policy interventions in terms of economic growth and social justice.

Many things can be achieved, not with more money, but with better procedures and with deep knowledge on the impacts of the interventions.

The country has a Strategic Development Plan that got general consensus, now it is the moment to operationalize and devise actions aimed to those goals, and not all the actions are the same. There is necessary to think deeply on the impacts on the overall economy.

To finish this presentation, I would like to draw the attention to the relevance that the budgeting process has in terms of policy making and the building of a Nation. After all, the State Budget, in democratic societies, is commonly known as the Law of Laws.

For sure, understanding that there is no better government than the one that rules for all the citizens, wide spreading the benefits of economic growth, especially to the most vulnerable in society, all these will be achieved.