Fiscal Policy: the Ultimate Verdict in Evaluating Poverty & Inequality Reduction Policies

A Case Study of Cape Verde from 2001 to 2016

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The adoption of a holistic approach

- **Fiscal policy**—the range of the government’s taxing and spending decisions—has a relevant impact on all aspects of sustainable development:
  - Economic, social, and environmental. Fiscal policy affects sustainable development through its impact on growth, the environment, and human resource development.
  - This impact operates at both a macroeconomic level, and
  - ... through the myriad ways in which governments’ tax and spending decisions affect incentives to work, spend, save, and invest.

- The **strengthening and reorientation of tax and spending structures** often has a central role

- This is the challenge .... doing nothing usually translates in a pro-rich bias economic growth, to avoid such bias income-earning potential should ensure that vulnerable people also share in the fruits

- Or in other words .... **It is not possible to deliver sustainable development if we are not able to associate economic growth with income distribution** .... And this requires people-centered policies.
Cape Verde :  
From Poverty to a MIC ...  
Four decades of change

Cape Verde, after its independence in 1975

- No Nation, no State, & no Human Capital
- Memories of frequent famines (1947, 30% of the pop. died);
- Only 10% of the land is suitable for agriculture ..out of 4.033 km²
- No resources, even water ..... due to low rainfall
- Limited internal market
- Zero Infrastructure
- Educational opportunities were scarce → only 2 high schools
- Per capital income was about US$190
- National treasury was zero → Had to appeal to Portugal for US$300,000
- Many (including Cabo Verdeans) did not foresee a future

In 2008 .... Cabo Verde graduates to MIC

- Per capita income increased from US$190 (1975) to US$ 3,800 (2012);
- Poverty reduced from 49% to 24%;
- Literacy among youth – 95%;
- Infrastructure development - 5th in Africa
- Cape Verde was considered among the “Top 10” FDI destinations in the world;
- Cape Verde was considered among the “Top 10” country reformers in the world;
- ICT Development index – 4th in Africa
- E-governance index – 6th in Africa

HOWEVER ...Cape Verde STILL FACES A HIGH LEVEL OF VULNERABILITY!
The Adoption of a PFM’s Holistic Path:
Treasury -> Budget Expenditures -> Budget Revenues -> Debt Management -> Deficit Financing

• The PFM reforms were delivered through four major axes:
  • 1) Get control of treasury management;
  • 2) Qualification of expenditures;
  • 3) Consolidation of revenues,
  • 4) Endogenous debt restructuring; and
  • 5) Efficient deficit financing.

• But more important ... policy makers need to be pragmatic and realist – avoid populist measures and have strong political will.
1st Axe: Get Control of State Treasury

• “Bankarization” of State Treasury - integrated and dematerialized system of procedures for revenue collection and spending for enforcement throughout the central administration.

• Short term liquidity increase and, consequently, liquidity risk decreased significantly impacting positively on short term financing costs, quickly creating fiscal space.

• Previously, short term treasury bonds financed with treasury liquidity placed in the banking system.

• Main Goal: stop paying interest rates on “our own money”.

• Low hanging fruit to compensate for the decrease in budget revenues.

• Digitization played a crucial role!
2nd Axe: Tackle first the expenditures side of the budget – due to higher elasticity

The Challenge: Expenditures efficiency

- Cut budget oil subsidies → align oil domestic prices with international ones → generate budget savings → fiscal space
- Rationalization of the tax incentive system (intentionally mentioned in the expenditure side). The tax incentives were completely proliferated after a more than a decade of managing them on an ad hoc and vested interest base, undermining the tax base and creating distortions in the functioning of the market.
  - Changed the logic underlying their attribution, moving from the sectoral approach to a result-based management approach. Everyone, regardless of the sector, activity, can access tax benefits as long as the investment contributes to macroeconomic objectives: investment, job creation, production diversification, internationalization, savings, etc. and consequently democratizing the access by cancelling the previous vested-interest approach.
  - Cut current expenditures (fat!) to create additional room for capital expenditures.
- Restructure of the VAT: excess credits vs refunds and the need to pay attention to tax compliance gap and tax policy gap.
  - Decrease in the policy gap was due to the policy change abolishing reduced rates, which is in line with good practices of efficient VAT legislation.
  - There are significant ‘trade-offs’ between policy gap and compliance gap.

VAT Policy gap decreased to 2.8 percent of GDP in 2014
... By doing so, fiscal space was created which was used to fight monetary poverty ...

- This additional fiscal space was channeled to fight monetary and non-monetary poverty.

- Monetary poverty:
  - Increase of the social pension: 285%;
  - Enlargement and consolidation of the social protection system:
    - Non-contributive beneficiaries increased by 100%.
    - Contributive, universalization of the social protection system: a) to all public administration (central and local); b) to all family members; c) householders, small holder farmers, SMEs, etc...

- Education: scholarships; school transportation; school feeding; school kits;

- In the middle of the crisis WFP withdraws from School Feeding program: thanks to fiscal space previously created we were able to switch to 100% financed with domestic resources.

Government Expenditure on Education (% of GDP)

![Graph showing government expenditure on education as a percentage of GDP from 2007 to 2014. The chart compares Cabo Verde, Lower-middle-income, Sub-Saharan Africa, Seychelles, and Mauritius. The graph indicates a consistent increase in expenditure for Cabo Verde and a decrease for Sub-Saharan Africa, showing variation among different regions.](source: SCD, WB, 2018)
... and also non-monetary poverty through a strong infrastructure program ...

- 4 international airports
- 9 ports, 2 deep water (Santiago e São Vicente)
- 2 atlantic cables & all islands connected
- Energy: 95% coverage rate
- E-government: integration of the back offices
3rd Axe: Revenue Side of The Budget – lower elasticity

- **Decrease corporate taxes from 35% to 25%:**
  - Strengthen enterprises’ fiscal competitiveness;
  - To support the private sector to cope with international crisis
  - Helped enterprises to better manage their working capital
  - For small and micro enterprises decrease from 20% to 15%

- **Decrease of income taxes from 45% to 35% (highest bracket) and from 15% to 11% (lowest bracket):**
  - To help families cope with international crises protecting their purchasing power

- **The Special Regime for Micro and Small Enterprises:**
  - Covers around 83% companies, at a single rate of 4% on turnover (replacing 5% VAT, 15% IUR, 15% INPS concerning the employer's charge) - clearly constituted a great boost to the economic dynamics in this business segment.
  - In addition, a reduction of 20 to 30% of the single special tax in the first two years for micro and small companies – an attempt to reduce the informal sector.

- **Digitization of the National Revenue Authority**
4th Axe: Endogenous debt restructuring

1st: Replace bad debt for good debt:
- ↓ public debt/PIB: 2005: 75.5%; 2006: 70.3%; 2007: 62.5%; 2008: 57.2% → mainly current expenditures
- ↑ public debt: 2009: 62.8%; 2010: 72.1%; 2011: 78.5%; 2012: 85.9%; 2013: 99.2% → mainly capital expenditures (infrastructure)

2nd: Replace domestic debt for external debt → peg with the Euro. Domestic debt decrease from 33% to 19%.

3rd: Release budget resources for investment → Revenues – Current Expenditures → current primary balance positive → release resources for public investment → crucial for the mobilization of external financing


“Between 2005 and 2009 → very large capital inflows entered Cabo Verde causing domestic credit boom, strong asset appreciation (touristic real state) and currency appreciation ..., increase in imports of goods ...”

- Window of opportunity → MIC transition period!
5th Axe: Efficient Deficit Financing

• We strengthened infrastructures in the country, both “physical” and “institutional”... through strong mobilization of concessional financing...

  • Average maturity was over 25 years, grace period 7 years...
  • Average interest rate was 1.41%
  • About 95.6% of the debt is on fixed interest rate, 3.9% floating interest rate and 0.5% no interest
  • 53% of our debt was in the Euro Zone, while 17% is in SDR
  • 52% of the debt was with Multilateral partners, 23% with Bilateral partners and 24% with Commercial entities

• The structure of external debt is important: 98% to official creditors ... and due to the peg with the Euro, it is mainly denominated in Euros...

• “The sustainability of an external debt depends on the relationship between the growth of domestic income + exports earnings AND the average interest rate + maturity profile of the debt stock → foreign capital inflows should be used to expand production capacities”
A Debt Strategy ....
High Stock (Debt/GDP) but reasonable Flows (Debt/Revenues)
The impact on poverty reduction and inequality

• **Social achievements have been equally impressive.** The *extreme* poverty rate—based on the national food poverty line—reduced from 30 percent in 2001 to 10 percent in 2015;

• Inequality fell as the Gini index dropped from 53 in 2001 to 42 in 2015.

• Improvements along non-monetary poverty indicators were even more important, including life expectancy (see figure 1b), maternal mortality, net primary school enrollment, and access to improved water sources.

• **Social Space:** long term investment in education, health → society could accumulate social space to cope with the international crisis → poverty rate decrease from 37% in 2000 to 24% in 2007
The impact on poverty reduction and inequality

**FIGURE 1. Cabo Verde has Made Remarkable Progress in Economic Growth and Human Capital Achievements**

**a. GNI per capita (1982=100)**

**b. Life expectancy at birth (years) 2000–2014**

- **Source:** World Development Indicators.
- **Note:** 1982 is the first year for which GNI data for Cabo Verde is available.
The impact on poverty reduction and inequality

Chart 2a: Poverty incidence and GNI/capita 2001–2015

- Extreme poverty (left axis)
- General poverty (left axis)
- GNI per capita (right axis)

Sources: Based on IDRF 2001, QUIBB 2007, and IDRF 2015 surveys

Chart 2b: Extreme Poverty rate (at USS 2.9 PPP) and GNI per capita 2001-2015 (in current USS)

Source: National Statistics Institute (INE). Right chart - WDI

Chart 3: Non-monetary Poverty

Source: World Development Indicators

Chart 4: Real GDP Per Capita Growth (%)

Source: World Development Indicators and country authorities
Thank You