EXECUTIVE SUMMARY

Chapter 1: Fiscal Policy for a Changing Global Economy

Over the past decade, fiscal policy has focused primarily on macroeconomic stabilization in response to shocks, notably the global financial crisis. Less emphasis has been placed on reforms to foster long-term inclusive growth by adapting to changing demographics, advancing technology, and deepening global integration. In many countries, public and private debt hover near historical peaks, long-term growth and development prospects are uninspiring, and inequality remains striking. With global growth slowing and uncertainty rising, fiscal policy should prepare for possible downturns—balancing growth and sustainability objectives—while also putting more emphasis on reforms to adapt to a fast-changing global economy. The latter will require inclusive and growth-friendly budget recomposition to upgrade tax, social spending, and active labor market policies, as well as investment in infrastructure for better public service delivery. Greater international cooperation is also needed to address multilateral issues, including corporate taxation, climate change, corruption, and, more generally, to achieve the 2030 Sustainable Development Goals (SDGs).

Preparing for the Next Downturn

The global expansion has softened. Growth is expected to slow this year in several large advanced and emerging market economies (China, euro area, United States), although it remains firm in many areas of the world (India and parts of sub-Saharan Africa). Downside risks have risen, mainly from unresolved trade tensions, heightened policy uncertainty, and financial market volatility. At the same time, public debt remains high in advanced economies and has increased in emerging market and developing economies. Major economies have turned to expansionary fiscal policies (China, euro area, United States); and tighter financial conditions and concerns over fiscal sustainability have pushed up borrowing costs in vulnerable advanced, emerging market, and frontier market economies.

In this environment, fiscal policy should tread carefully to balance growth and sustainability objectives. Where actual output exceeds potential (United States), or borrowing costs are high and financing needs are large (Brazil, Italy) and enhancing market access remains important (Argentina), growth-friendly fiscal adjustment remains appropriate to reduce debt vulnerabilities and build buffers to be deployed in case of a major downturn. Where there is some fiscal space and risk of a sharper slowdown, there could be a case for limited, high-quality fiscal stimulus (Australia, Germany, Korea), in some cases coupled with a credible medium-term consolidation plan (China, Japan). In low-income developing countries, fiscal policy should support development objectives subject to financing constraints. And if a severe downside scenario were to materialize, available monetary policy tools could be complemented with fiscal easing by countries that have appropriate fiscal space and financing conditions; in the euro area, a synchronized fiscal response, albeit appropriately differentiated across member countries, can strengthen the area-wide impact.

Adapting to Global Trends

To foster higher and more inclusive growth, fiscal policy should adapt to key trends reshaping the global economy. Shifting demographics, rapid technological progress, and rising global economic integration bring structural challenges. Advanced and many emerging market economies are faced with aging populations, raising concerns about the sustainability of public pensions and healthcare. Low-income developing countries and several emerging market economies must create jobs and upgrade public infrastructure as well as education and healthcare services to meet the needs of their rapidly expanding and urbanizing populations. Social spending and tax policies in all countries need to keep pace with the labor and product market changes brought on by technological advances and by deeper trade and financial links across countries. Adapting policies to global trends would foster long-term economic growth—a crucial ingredient for a durable reduction in public debt burdens—and spread the gains from openness and innovation within and across countries. This would also help to restore the public trust in institutions necessary for economic stability.

Where there is limited budgetary room, such adaptation will have to occur through budget recomposition. Key to this process will be reprioritizing expenditures to achieve cost savings by cutting wasteful spending and curbing corruption in all countries. For example, removing fuel subsidies through efficient pricing could gradually yield up to 4 percent of global GDP in additional fiscal resources. Public financial management reforms can also expand the fiscal envelope through efficiency gains. Managing public sector assets more effectively could yield up to an estimated 3 percent of GDP a year in additional revenue in some countries. In emerging market and developing economies, where tax revenue remains relatively low, revenue mobilization will have to play an important role given the significant infrastructure and social spending needs to meet their SDGs. Sub-Saharan African countries could raise, on average, 3 to 5 percent of GDP in additional revenue over the next five years through reforms that improve the efficiency of current tax systems.

International cooperation is also essential to amplify and spread the gains from reforms globally. Prime issues that could be addressed through a multilateral approach include taxation of multinational companies (including digitalized ones), climate change (which could be mitigated through carbon taxes), and corruption. Coordinated international support and financing, combined with improvements in governance in both donor and recipient countries, could complement the efforts of low-income developing countries to achieve their SDGs. A renewed effort to work within an improved multilateral structure would complement national policies adapted to a fast-changing global economy.

Chapter 2: Curbing Corruption

Corruption—the abuse of public office for private gain—distorts the activities of the state and undercuts efforts to achieve sustainable and inclusive economic growth. Corruption helps some people evade taxes, whereas others often end up paying more. The loss of revenues can also hamper governments' ability to provide social spending. Moreover, the quality of public services and infrastructure is undermined when government decisions are driven by bribes or nepotism. Ultimately, corruption erodes trust in government and can lead to social and political instability.

This chapter presents evidence that the fiscal costs of corruption can be substantial for economies at all levels of development. For example, comparing countries at similar income levels, the least corrupt governments collect 4 percent of GDP more in tax revenues than their peers with the highest levels of corruption. Based on such cross-country comparisons, if all countries today were to reduce corruption by a similar extent, on average, as those that reduced it over the past two decades, global tax revenues could be higher by \$1 trillion, or 1¼ percent of global GDP; the gains would likely be greater considering that lower corruption would increase economic growth, further boosting revenues. Countries that managed to reduce corruption significantly were rewarded with surges in tax revenues as a share of GDP (for example, Georgia by 13 percentage points, Rwanda by 6 percentage points). The evidence also suggests that corruption distorts how governments use public money. Less corrupt countries dedicate a higher share of resources to social spending (for example, among low-income countries, the share of the budget dedicated to education and health is one-third lower in highly corrupt countries). In addition, more corrupt countries overpay for building roads and hospitals, and their school-age students have lower test scores.

Fighting corruption requires mustering political will. To ensure lasting improvements, however, it also requires developing good institutions to promote integrity and accountability throughout the public sector. Drawing on new data regarding a large set of fiscal institutions and individual country experiences, the chapter provides specific advice by examining in greater detail where corruption leakages occur in government operations and how different institutions can help reduce such leakages. Some of the lessons for national decision makers are:

- Build a professional civil service, based on transparent, merit-based hiring and remuneration procedures. It is vital for heads of agencies, ministries, and public enterprises to promote ethical behavior by setting a clear tone at the top.
- Invest in high levels of transparency and independent external scrutiny, to allow audit agencies and the public at large to provide effective oversight.
- Focus on "hotspots" where international experience suggests that corruption occurs frequently—for example, public procurement, infrastructure, complex goods and services that are hard to price, natural resources, and public enterprises.

- Increase the chances of success by improving several mutually supportive institutions to tackle corruption. For example, reforms to tax administration will have a greater payoff if tax laws are simplified and the scope for discretion by tax officials is reduced. Efforts to improve integrity in the civil service or to pursue tax evaders will depend on timely and evenhanded court proceedings. Likewise, the benefits of fiscal transparency are enhanced by the presence of a free press.
- Commit to improving institutions assiduously to reduce vulnerabilities to constantly evolving corruption challenges. Adopting new technologies helps to strengthen key fiscal functions, such as budget processes and revenue administration, as well as internal controls. For example, electronic procurement systems (e-procurement) can be a powerful tool to fight corruption by promoting transparency and improving competition (for example, Chile, Korea).

Corruption is also a global problem demanding greater international cooperation to fight it. A growing number of international initiatives are under way to fight corruption and to make it more difficult to hide corrupt proceeds. However, more could be done:

- Countries should be more proactive in combating bribery by national companies that bribe officials in foreign countries, aggressively pursuing anti–money laundering activities, and reducing opportunities to hide corruption proceeds in opaque destinations.
- Greater transparency in the extractive industries (oil and mining) is needed given the presence of large economic rents and the role of major international players.
- Despite some improvements, international exchange of information remains limited. More cooperation is critical to fight tax evasion and to investigate and prosecute corrupt acts.
- Finally, donors and international institutions can lead by example, by strengthening their own transparency. They can also help by disseminating good practices in institution building. This is the goal of this chapter.