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Underlining issues of emerging economies: a case of East and Southeast Asian Countries

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ABSTRACT

Overall development of a country largely depends on the economic policy instruments particularly fiscal and monetary policy to streamline the development and continue the developmental progress. These two policies have significant effects on long-term growth. It is noticed that policy adoption and reforms in both fiscal and monetary policies undertaken by Southeast Asian nations during the 1960s through 1990s have contributed to their advancement. This paper discusses the strategies for flourishing as emerging economies. Examples from Singapore, Thailand and Vietnam are highlighted in this study. It is found that prudent fiscal and monetary policy, effective discounting and interest rate; modernized tax system and most importantly policy regime are the contributing factors of these emerging economies. However, in spite of high-income growth and development because of supportive these policy initiatives, administrative and politico-economic constraints challenged the path of economies. Long-term development strategies are suggested to sustain the growth and continue the development pace.

KEYWORDS

Fiscal Policy; Monetary Policy; Policy Regime; Discounting Rate; Interest Rate; Tax System

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1. Introduction

Overall development of a country pivots on the economic activities mostly supported by two policy instruments, i.e., the fiscal and monetary policy. Fiscal policy refers to the management of government expenditure and revenue-generating measures, such as taxes and subsidies, in order to impact economic activity (Henderson, 2008). Fiscal policy differs from monetary policy in that it only focuses on taxation and spending and is usually carried out by an executive underneath the laws of a legislature, on the other hand, monetary policy is concerned with the supply of money, lending/interest rates and inflation and is usually carried out by the central banks. Fiscal policy is used by governments to manage the economy's aggregate demand to ensure stability in the price level, achieve full employment, and economic prosperity (Friedman, 1948). According to Keynesian economics, the best strategies to promote aggregate demand are to increase government spending and lower tax rates; and to decrease spending and raise taxes once the economic boom has begun (Lavoie, 2012). In periods of recession or sluggish economic activity, Keynesian economists suggest that these strategies should be used as a vital tool for building the foundation for strong economic growth and achieving full employment. A budget surplus can be used by governments either to slow down rapid economic expansion or to ensure price stability when inflation is too high. According to Keynesian theory, reducing expenditure from the economy reduces aggregate demand and causes the economy to contract, stabilizing prices (Tobin, 1993). Smithies (1948) describes fiscal policy as a strategy for the government to use its spending and revenue programs to achieve desired outcomes while avoiding unfavourable outcomes in terms of national income, productivity, and employment. To put it in a simpler way, fiscal policy is simply the budgetary policy of the government to deal with excessive economic expansion, galloping inflation or sluggish economic activity. Governments adopt an expansionary fiscal policy by cutting taxes and increasing spending when economic activity reduces and the economy falls into recession. The success of such policy depends largely on the early anticipation of the depth of the recession (Auerbach and Gale, 2009). On the other hand, governments adopt a contractionary fiscal policy by increasing taxes and reducing spending when the economy is rapidly expanding leading to excessive pressure on the price level. Thus, fiscal policymakers are left with two fundamental policy tools i.e. government expenditures and tax revenue. It includes two distinct but related decisions: governmental spending and tax rates and arrangements. The quantity of government spending, the incidence and effect of taxes, and the relationship between expenditure and revenue all have a big impact on the free market economy.

To a large extent, monetary policy is about managing expectations (Woodford, 2010). Monetary policy is dependent on the relationship between the total money supply in the economy and the lending rates. Monetary policy utilizes several strategies to influence variables such as economic progress, currency exchange rates, inflation, and unemployment by influencing one or all of these factors (Tobin, 1983). Being the sole issuer of money, the monetary authority has the power to manage interest rates by controlling the total circulation of money. Monetary policy was first introduced in the latter part of the 19th and at that time it was utilized to maintain the gold standard (Cooper et al., 1982).

A monetary policy is said to be contractionary if it is meant to reduce the amount of total supply of money or to increase the rate of interest. On the contrary, an expansionary monetary policy is meant to expand the monetary base or to lower the rate of interest. Additionally, monetary policies are classified as accommodating if the central monetary authority's interest rate is designed to promote growth in the economy; neutral if it is neither meant to promote economic expansion nor to battle inflationary pressure; and tight if it is meant to combat inflationary pressure. To achieve these goals, monetary policymakers can use a variety of methods, including fiat rate increases, monetary base reductions, and reserve requirement increases to have an expansionary effect on the money supply (contractionary effect if reversed). The effectiveness of monetary policy

transmission channels such as stocks, bonds, the foreign exchange market, and bank lending rates determines how long it takes for a monetary policy to take effect on the economy (Mamun and Rahman, 2021). Even though the Bretton Woods arrangement meant that the majority of countries formulated their fiscal and monetary policies separately, universally fiscal policies have been formulated independently of the monetary policy since the 1970s (Debrun et al., 2009). However, monetary policy is critical in shaping a country's economic direction since money and credit in a contemporary economy have a significant impact on the direction, nature, and amount of economic activity. By matching the money supply to the necessities of growth, guiding the flow of funds into the proper channels, and making credit available to specific fields of economic endeavour, a carefully planned monetary strategy can considerably stimulate economic growth.

Over a period of more than two to three decades, some of the East Asian countries have managed to secure substantial economic success by sustaining rapid growth. In 1965, these countries' per capita income was only 13% of that of the United States, but by 1998, it had risen to 60% (Mundle, 1999). This paper examines the policy regimes as well as fiscal and monetary policy options of different countries that lead to sustained long term development. While much has been written about the importance of tools like monetary and fiscal policy, this article sought to shed some light on the concrete measures implemented by the developed economies of East and Southeast Asia. This paper provides valuable insights into the policy issues faced by advanced East and Southeast Asian countries, which can serve as a helpful reference for other developing economies dealing with similar challenges.

2. Policy Regimes

Asian economies like the People's Republic of China, Japan, Singapore, Korea, Malaysia, Taiwan, Indonesia and Thailand have recorded a commendable pace of economic growth since 1965. However, advanced Asian economies (AAEs), i.e., Singapore, Korea, Japan and Taiwan exceed far ahead of the market economies of South East Asia. On the other hand, some of Southeast Asia's transitional economies, such as Lao PDR, Myanmar, Cambodia and Vietnam, have also started growing rapidly. The formation of the ASEAN Economic Community (AEC) has also contributed to the recent development of these countries (Anis et al., 2021). The South Asian countries like Bangladesh, Pakistan, Nepal, India, Nepal, Maldives and Sri Lanka have achieved moderately slow per capita growth of 2 percent between 1965 and 1990 (Akram, 2013). However, the patterns of economic growth of different countries show a wave-like curve with lots of fluctuations (Abramovitz, 1989). For example, Japan recorded growth rates exceeding 10 percent during the 1960s with a fall to 4 per cent between 1970 to 1990, and around 2 percent in the 1990s. For other Asian advanced economies growth rate reached the maximum point at around 10 percent in the 1970s, while for South-East Asian economies and other transitional economies, growth reached the peak in the 1990s. Asian advanced economies and Southeast Asian Market economies initiated liberal market reforms during the 1970s (Akyüz et al., 1998). China also gradually initiated pro-market policy reforms during the same period. South Asian countries did not introduce pro-market policy reforms until the 1990s. Following the liberalization of the markets, the South Asian countries were expected to grow rapidly as South-East Asian countries. The Government's visible hand and the market's invisible hand have guided the East Asian miracle (Yanagihara & Sambommastu, 1997).

Formulating a forward-looking, effective and functional monetary policy is one of the common challenges that developing countries may always have to overcome. The biggest concern is that few emerging economies have got themselves in large government debt. The difficulty of projecting money demand, as well as budgetary pressure to impose the inflation tax by excessively increasing the money supply, add to the complexity. Previous performance records of many developing countries' central banks in terms of managing the monetary policy is very poor. This is largely due to the fact that the central banking system in an emerging economy is not

autonomous of the state; therefore effective monetary policy comes second to the government's electoral ambitions or is utilized to achieve non-monetary purposes. For that and various reasons, emerging economies that aim to implement effective monetary policy may pursue dollarization or establish a currency board. The government's hands are effectively tied by these financial entities, preventing it from interfering, and these measures are expected to transplant the host nation's monetary policy. In most countries, either the central bank or the ministry of finance is in charge of monetary policy. The impacts and efficiency of the monetary policy on controlling the overall economic environment range greatly between Neoclassical and Keynesian economics; there is no broad agreement on how monetary policy influences actual economic indicators like gross production or income and unemployment and how much it influences them. Though Neoclassical and Keynesian economics vary greatly on the impacts and efficiency of the monetary policy, both schools of thought take into account that monetary policy influences monetary indicators such as price levels and the rates of interest.

3. Public expenditure and macroeconomic policy

There are tangible policies pertaining to fiscal management and government spending pursued in the advanced Asian economies which heightened the living the other circumstances. The successes in these countries provided insightful lessons for growth-oriented regulatory reforms in many developing economies. The major thrust in the macroeconomic policies in the advanced Asian economies was to pursue and sustain high export-led growth. Other major interventions include a low level of public expenditure, surplus or minimal deficit budget, and budgetary reforms to control inflationary pressure. Export-led growth is driven by ensuring price stability and cost competitiveness. The ratios of public expenditure in the advanced Asian economies are very low, which is under 30 percent in Japan, Korea and Singapore. In these economies, expansionary fiscal policies are applied every once in a while, and at the same time, fiscal breaks help them to tackle inflationary pressures. During their rapid growth period, Singapore adopted a surplus budget while Japan implemented a balanced budget policy. Korea and Taiwan also continued fiscal deficits. In these countries, public investment programs were funded by external assistance, and in case of inflation, they cut public expenditure sharply to re-stabilize their economies. Indonesia, Malaysia and Thailand during their high growth phase also maintained fiscal policies similar to those of advanced Asian economies.

The experiences of Southeast and East Asian economies indicate that avoidance of huge fiscal deficit is an essential macroeconomic condition for rapid economic advancement. South Asian countries could not attain sustainability in economic growth even after several years of efforts towards budgetary reforms. Fiscal deficits in these economies range between 6 to 10 percent of their GDPs (Asian Development Bank, 1996). India has seen a growing fiscal deficit since the 1950s and during the 1980s. It has even experienced a current account deficit, and its fiscal deficit strikes at 9 percent and current account deficit at 5 percent (Mundle & Rao, 1997). High-interest liabilities also squeezed the resources required for public investments in India. Excessive borrowing by the public sector crowded out private investment and drove up their rate of interest in India (Mundle, 1999). Such circumstances affected both public and private investments, slowed down expected economic advancement, and affected the national supply chain. Such effects sequentially induced inflationary pressures on the economy and generated an excess of consumer spending to the external sector, which ultimately led to the shortage in the current account.

China and Vietnam have been successful in sustaining high growth for a significant period of time. Such growth is reflected in their success of market stabilization, for quite some time, with fiscal strategies like the advanced Asian economies. Other features of these economies include their fundamental structural reforms and wider government revenue-generating sources, and avoidance of deficits on the current account unlike the South Asian economies (Wong et al., 1995).

4. Allocation of public expenditure

Macroeconomic policies in the advanced Asian economies are characterized by export-led growth through optimal resources for the promotion of accelerated infrastructural and human capital development. Savings in the public sectors, achieved through careful current expenditures, ranged between 7 to 10 percent of GDP in these economies, and occasionally as high as 15 to 20 percent in Singapore. Such savings were redirected towards investments in large scale infrastructure development projects and towards handling inflationary pressures. In Japan capital expenditure on infrastructures reached around 30 percent in the mid-1970s (Mundle, 1999), and in Korea, it reached around 25 per cent of the gross public spending. When Taiwan cut its deference expenditure to only 16 percent in the 1990s from the earlier 40 to 50 percent during 1950 to 1970, economic expenditure increased, and capital projects for infrastructure and human development were undertaken.

The fast-growing South-East Asian economies on the other hand maintained a large current account budget surplus for their continued public investments, and public investment saw large scale borrowing on the other hand. This process, however, did not put much adverse pressure on private investment. In China and Vietnam, public investments, but not current expenditures, were financed with external sources, and the governments have been net savers. South Asian economies have not been savers. In the Indian case, total revenue sometimes fell even short of current expenditure. This builds on public debt pushing the economy toward debt servicing liabilities.

Advanced Asian economies allocated highly in social service sectors, especially education. Social expenditure in the industrialized economies accounted for 60 per cent of overall government spending – 40 per cent for social safety net services and 20 percent for social services programs i.e., education and health. East Asian economies spend one-third of the total public expenditure for social sectors, while around 20 percent of the public spending is allocated for education. Social security expenditures in Japan and Taiwan resemble those in the Western OECD countries. Social spending in Japan is as high as 70 percent, while the education sector still receives 13 percent of government spending. Singapore allocates 21 percent for education.

In the advanced Asian countries, low levels of total government spending did not reduce social spending, which is consistently considered important. They also avoided expensive social security systems and allocated a larger share of public expenditure to education. South Asian economies also avoided large scale social security spending, but contrarily large allocation is consumed by general administration. Government expenditure in education in the South Asian economies amounts to less than half of that in the advanced Asian economies. These economies ensured distinctive policies to put together the resources from both public and private sectors within the social segments and to attach emphasis on primary education. While the enrolment at the higher education level in the advanced Asian economies was almost equated with other Asian countries, 100 percent admission in primary school was recorded, while the Asian average in primary enrolment was around 75 percent (Mingat, 1998). The advanced Asian economies relied upon education at higher levels on private resources to fulfill both immediate and circumstantial costs (Mingat, 1998). Simultaneously, merit and means based stipends and student loans were introduced to minimize the obstacles to higher education. The advanced Asian economies not only maintained a low student-teacher ratio but also provided higher compensations for quality teachers and impressive student performance. South Asian economies contrarily provided higher priority to higher education for public spending, while primary education found low teacher salaries and resultantly poor quality teachers.

The advanced Asian economies provided for mandatory health insurance on the basis of per capita income levels. However, for the South Asian economies and other low per capita economies in Asia, it would be difficult to provide such health care insurance (Mundle, 1998). In such economies, health insurance could be offered to the high-income people in the corporate sector and the government, and thus private financing could be accrued in order to undertake preventive health care schemes and to achieve higher social returns to public expenditures.

Unfortunately, in many Asian countries including South Asia, public spending is directed towards curative treatments and expensive hospital care.

The advanced economies of Asia made efficient allocations taking into consideration the principles of market failures, and targeted public expenditures with the largest externalities or greatest social benefits above private returns. These countries attach high priority to macroeconomic stability, and their fiscal goals were set for infrastructural and human capital development. Such strategies were very consistent with the pursuance of export-led growth. Primary education and healthcare services remained their persistent redistributive policy trusts. Private sectors were encouraged to provide most of the social services apart from education and medical services. However, Japan, Korea and Taiwan were under the western security blanket following the WWII, and therefore, received external assistance for their defence spending, while they could invest more for physical and social infrastructure. A volatile security environment in some South Asian and transitional Asian economies results in waste of resources, and some economies benefit potentially from peace situations.

An important milestone in the advanced Asian economies is the lost cost of wages and salaries. Their labour market remained flexible, which led to cost competitiveness and export-led growth. Low wages and salaries as well as controlled public employment kept government consumption low and enabled the government to invest more for physical and social infrastructure development.

5. Monetary Policy Tools

Monetary policymakers all over the world generally use three fundamental strategic tools to achieve the targeted outcomes of the monetary policy. The first strategic instrument is open market operation, which is used to manage the overall liquidity in the economy. Open market operations are essentially the buying and selling of government bonds with a maturity of one year or less. The monetary authority buys the government bonds back when it intends to increase the money supply and sells the same if it wants to reduce the total supply of money in the economy. These open market activities (buying and selling of the government bonds) are carried out between the central bank and its affiliated banks and major financial entities. When the central banks buy or sell government bonds, they alter not only the monetary base, which affects lending rates, but also changes the price (yields) of the government bonds. Thus, the central bank can use this monetary tool to simultaneously influence the interbank interest rates and yields of the short-term government bonds simply by simply changing the money supply in the economy (Cheung & Chinn, 2001).

The second strategic monetary tool is managing the money demand in the economy through interest rates. Demand for anything has a negative or inverse relationship with price. Money demand is also not different. The only difference here is the price for money is actually the interest rates payable by the borrower. Central banks formulate monetary policy targeting the interest rates to control the money demand. It can also set the banking system interest rates i.e., discount rate, bank rate, repo rate and reverse repo rate. As money demand is also price sensitive like any other demand, a rise in the interest rate shrinks money demand and vice versa. The central bank's initiatives to lower the interest rates does not work if the rate of interest is already at or very close to zero. During a deflationary situation when inflation is very low it can happen (Reifschneider & Williams, 2000) which is theoretically termed as a liquidity trap (Svensson, 2003).

The third strategic tool is to minimize volatility in the financial sector by keeping a cash reserve by the banks as decided by the monetary authority. Banks must keep a fraction of the total deposits as a cash reserve to fulfil the cash demands of the depositors (Fama, 1980). The fraction of the total deposits banks need to keep as a reserve is usually decided by the monetary authority, which is generally termed as reserve requirements or reserve ratios. Banks can create money by lending several times the amount of actual deposit which is the money multiplier effect (Carpenter, 2012). The quantity of loanable money available to the banks is reduced when

reserve requirements are increased. Similarly, a reduction in reserve requirements, on the other hand, boosts banks' lending capacity and subsequently creates inflationary pressure on the economy. Monetary authorities can control credit growth and actual money supply in the economy by adjusting the reserve requirements (Moore, 1991).

Open market operations, setting financial sector interest rates, as well as setting banks' reserve requirements to minimize systemic risk are common techniques in use by monetary authorities to achieve an appropriate supply of money to stabilize and ensure economic expansion, as well as control or mitigate the consequences of economic slowdown and inflation. By balancing the supply of money in the banking sector in terms of the aggregate market's demands, these basic demand, supply, and risk mitigation approaches sustain the equilibrium rates of interest and inflation at stated target levels.

6. Monetary Base

Monetary authorities can adjust the size of the monetary base to implement monetary policy. To alter the monetary base, monetary authorities purchase and sell government bonds which is termed open market operations. In return for deposited money at the central bank, it purchases or sells reserve assets. Those deposits can be exchanged for cash. The monetary base, which is the central bank's general obligations in its own monetary unit, is made up of such currency and deposits. Member banks can usually employ base money as a proportionate reserve and increase the money circulation in the economy.

7. Reserve Requirements

Banks are subject to regulatory supervision by the monetary authorities. Changes in the percentage of overall assets that banks must retain in reserve with the central bank can be used to execute monetary policy. Banks only keep a tiny fraction of their assets in cash that can be withdrawn immediately; the remainder is put into illiquid assets like mortgages and loans. Central banks alter the availability of loanable money by adjusting the percentage of total assets kept as liquid cash. The money supply changes as a result of this. Fluctuations in reserve requirements are rarely made by monetary authorities since they might cause turbulent adjustments in the supply of money and destabilize the financial sector.

8. Lending by Discount Window

Central banks often provide a discount window through which banking institutions and other financial intermediaries can take loans from central banks to cover short-term cash shortfalls resulting from internal or external disturbances. This fosters a sustainable monetary ecosystem in which people may save and invest, enabling overall economic growth.

Short-term interbank market rates are often higher than the interest rate charged on the loans taken from the discount window (also known as the discount rate). Using the discount window, financial intermediaries can change credit conditions (i.e., how much money they can lend out), altering the supply of money. Monetary authorities can influence the economic situation, and consequently employment generation and economic progress, through the discount window.

9. Interest Rate

Monetary authorities can indirectly alter the money supply by adjusting the nominal rate of interest of the economy. For example, a rise in the nominal interest rate will shrink the overall supply of money in the economy.

Monetary authorities' ability to change the economy-wide nominal interest rates varies from country to country. Although this nominal rate of interest has a substantial impact on other market interest rates, no precise correlation exists. Open market operations account for a modest percentage of the overall bond market volume in the USA. Because the same tool — open market operations — affects both the amount of money in circulation and the rate of interest, it is impossible to set separate targets for each; instead, the policymaker has to select which one to regulate. According to a meta-analysis of 70 scientific research on financial intermediation, a 1% rise in the interest rates causes a 0.3 per cent fall in price levels, with the largest impact arriving within 6 and 12 months (Rusnák et al., 2013).

Other countries' central banks could be successful in determining precise interest rates on lendings, savings, and other capital instruments. A monetary authority can reduce the amount of total money circulation in the economy by raising the interest rate(s) under its control since a high-interest rate incentivizes saving and disincentivizes borrowing. Both of these impacts shrink the monetary base.

10. Macroeconomic Policy in the International Economic Framework

In international economics, the biggest challenge of an efficient monetary policy is how monetary policy should have been implemented in open and interconnected economies. According to the traditional perspective, international macroeconomic interconnectedness is only significant if it has an impact on local production disparities and inflation, and hence macroeconomic policy suggestions can easily ignore openness (Wade, 2010). This viewpoint is based on two underlying assumptions, as emphasized by Corsetti and Pesenti (Corsetti & Pesenti, 2005), and Devereux and Engel (Devereux & Engel, 2003): high exchange rate sensitivity of import costs, and smooth global financial markets that support the effectiveness of flexible price allocation. A large portion of the global best possible monetary policy literature is devoted to the rejection or misinterpretation of these assumptions found in the scholarly investigation. This global approach is distinguished by three policy trade-offs:

Firstly, research, e.g. by Gopinath and Itskhoki (Gopinath & Itskhoki, 2008), reveals that import prices only represent a poor reflection of exchange rate swings, adding credence to the opposing notion of local currency pricing (LCP). As a result, monetary policy is shifted from the traditional approach of a trade-off between production disparities and nonlinearities in international relative prices and toward CPI inflationary pressure control and real effective exchange rate stability.

Second, strategic interactions and competitive devaluations are a feature of internationally efficient monetary policy due to cross-border spillovers in quantities and prices (Corsetti, Meier & Müller, 2009). In the lacking of global policy coordination, national governments of various countries are enticed to manipulate trade conditions to boost national welfare. Despite the fact that Corsetti & Penseti (2005) found that the benefits of global policy coordination are minimal, they may become quite important when weighed against the benefits for international noncooperation.

Third, if financial market distortions preclude global efficient allocation, open economies encounter policy trade-offs. Despite the fact that the real exchange rate soaks disturbances in present and projected fundamentals, the adjustments do not always lead to a preferred distribution and could even worsen consumption and employment misallocation at both the national and overseas levels. Because, unlike perfect markets, both the Phillips curve and the loss function incorporate a welfare-centric dimension of cross-country asymmetries. As a result, national objectives, such as production disparities or inflation, are traded off with the stability of exogenous factors like trade terms or the demand mismatch. Therefore, at the expense of little inflation, the best monetary policy is to address demand mismatches and/or international comparative prices (Corsetti & Dedola, 2005).

Corsetti et al. (2009) summarize the current state of studies in the area of international monetary policy rules.

Therefore, optimal monetary policy should address the combination of internal variables like production disparities and inflation, with currency inconsistencies and misallocation of demand across countries and inconsistent exchange rates and winds of global imbalance. This has a significant impact on the country's financial situation.

11. Resource Mobilization and Tax Policy

Advanced Asian economies succeeded in mobilizing sufficient resources for public expenditures as well as current expenditures, and thereby accumulated public sector savings. Japan relied largely on an advanced taxation practice for resource mobilization, while Singapore relied on nontax revenues and innovative methods.

In Japan, the low level of government spending is equalized by their relatively low tax burden. Japan kept its tax to GDP ratio below 20 per cent even towards the end of its rapid growth phase. It has one of the lowest GDP to tax ratios among the OECD countries even after Japan raised the tax rate in the 1970s oil crisis (Mundle, 1998). It signifies that neither a high level of government expenditures nor high tax rates are necessary for sustained growth rates. A larger portion of direct tax characterizes Japan's taxation structure. An empirical model of structural change in taxation shows that as the conventional economy modernizes, the focus of alternative tax sources shifts from lax tax dominance to trade duties, local indirect taxes, and ultimately direct taxes (Hinrich, 1966). Japan achieved a direct tax share of more than 54 per cent of gross tax revenue in the 1950s, and now its indirect tax is very low at only 13.1 per cent of GDP, and the United States has a similarly low indirect tax (16.5 per cent) share among OECD countries.

The high public spending on social services such as education in Japan, which was initially funded by direct taxes collected from the affluent, benefited society at large. However, on the other hand as a result of some extends of tax incentives, revenues were lost, tax fairness was adversely affected, and market-based resource allocation was distorted. In the 1950s and 1960s, losses due to the tax incentives were estimated at over 10 percent of the gross fiscal tax generation (Ishi, 1993). Individual income tax incentives, corporate income tax incentives, and export promotion incentives for encouraging individual savings and real estate development, business savings and investment, and export promotion respectively generated revenue losses to some extent. Ishi (1993) hinted at the benefit of the richest income groups out of tax incentives at the expense of middle-income groups. However, the tax framework has been astoundingly versatile, but it did not prompt persistently increasing the tax of GDP ratio. Another important aspect of the economy is that it sought after a functioning industrial policy to advance the designated trade drove development, wherein fiscal interventions were the main tools. During the oil shocks of 1973 and 1979, the long-term growth rate was slowed down, and persistent fiscal deficits were pursued. At that stage, Japan pursued a welfare state, which required pushing up the level of government spending leading to fiscal deficits. Reductions were stopped, most special tax incentives were cut off, and thereby revenue losses were reduced. Comprehensive tax reform further involved reduction in individual and corporate tax, the introduction of consumption tax, and lately a shift to expansionary fiscal policy. When direct remained the mainstay of the prudent tax system, removal of tax incentives ultimately expanded the tax base and enhanced fairness and impartiality.

Direct taxes and levies such as estate and property tax, income tax and vehicle tax characterize the Singaporean tax system, where 48 per cent of the total tax revenue comes from income tax. Company income tax has been curtailed to 26 per cent which was around 40 per cent in 1986, while individual income tax was raised from 2 percent to 28 percent during the period. Like in Japan, Singapore levied a consumption VAT at 3 percent, which is called Goods and Services Tax (GST) in 1994, in order to reduce direct taxes.

Singapore took a different path, relying on nontax revenue and an off-budget provident fund plan to support social safety programs and other welfare services. Singapore's tax system generates half of the government's total

income, with the remainder coming from various charges, service fees, levies, and the profits of statutory boards and government companies. Land leasing, which is a state monopoly, generates a large portion of the revenue, accounting for nearly 33 per cent of total nontax income (Asher, 1995). Unlike Japan, Singapore does not have an expensive social security system that is paid from the budget; instead, it has an obligatory self-financing social security system called the Central Provident Fund (CPF) that is funded from outside the budget. The ratio of contribution to this fund fluctuates over time and is utilized as a macroeconomic stabilization tool. This rate was set at 10 percent in the 1950s, 50 percent in 1984, 35 percent in 1986, and was lowered to 40 percent in 1994. Matching contributions of 20% are made by both businesses and employees. The regular account is credited by 33 per cent of the individual account which is utilized to fund residential purchases, authorized investments, higher studies, and the pension plan. A further 6 per cent is allotted for a healthcare fund, with a portion set aside for an elderly and disability support account. Singapore has a high savings rate. The CPF is a useful tool for financing social protection programs, universal health services, education, accommodation, and investments. One advantage in Singapore is its citizens work in the organized public or private sector, which is unlikely in the developing countries which have a population in diverse unorganized sectors.

Tax reform in transition economies entails not only the change itself but also the structure of the entire tax system as well as administration. The Profit Tax, also known as Corporate Income Tax and Turnover Tax, was used by the departments of finance and budget to collect taxes from state firms under the previous tax system. The move from manufacturing and trading taxes to income and consumption taxes, which itself is more straightforward in transition economies than in developing market economies, is a major concern. For a transition economy to convert to a market economy, state businesses, many of which are losing money or on the edge of liquidation, are under a lot of pressure. Trade and production taxes become the focus of the transition. Trade tax as a ratio of total revenue in Vietnam is remarkably higher now than before (Mundle, 1997). However, in order to achieve long-term economic growth and to comply with regional trade agreements, such tariffs will have to be gradually decreased. Personal and corporate tax revenues are rapidly growing as part of tax reforms. In 1994, China enacted a well-crafted VAT law (Wang, G. 1997), while Vietnam enacted its own VAT act in 1997.

Aside from the difficulty of introducing VAT, transitional economies confront difficulties in modifying appropriate administrative equipment and manpower. Furthermore, successful fiscal decentralization necessitates VAT harmonization with tax allocations to other levels of government. Another issue confronting transition economies is international tax rivalry, which limits their ability to raise additional money. The Singapore CPF model for financing social security and social services can be studied and adapted by transition economies.

South Asian market economies confront the same issues as Asian transition economies when it comes to tax reform. In economies like India, establishing an efficient tax administration and decentralizing tax assignments remains a challenge (Rao, 1997). South Asian countries rely heavily on manufacturing and trading taxes, which account for over 80% of gross tax collection. The largest amount of resource allocation distortion is caused by such taxes. Bangladesh currently derives one-fourth of its revenue from VAT, which was introduced in 1991/92. South Asia's tax administration is still ineffective, with little enforcement and a low revenue yield.

12. Concluding Remarks and Learning for South Asia

The priority of the advanced Asian countries in the context of fiscal policy is evidently in public spending on infrastructure and social services in order to encourage fast economic expansion while maintaining equity, avoid unsustainable social safety programs, and replace them with off-budget and self-financing systems like Singapore's. It has also been prioritized to shift from manufacturing and trading taxes to VAT and consumption and income taxes. The implementation of tax reforms, particularly administrative systems and staff quality, is a

major restriction for Asian transitional countries and South Asia, rather than a lack of knowledge of the essential policy agenda. The current political and economic environment, as well as foreign and domestic variables, present a challenge to growth-oriented fiscal and monetary policy. Little variations in taxes, interest rates and exchange rates can cause capital to flow from one country to another; therefore Asia's less developed countries will require foreign capital to sustain increasing rates of investment. In South Asian countries, political interest groups put pressure on the national budget to accommodate competing agendas. Reforming state-owned companies in developing economies such as Vietnam and China was difficult. A guiding principle for South Asian developing countries and other transitional economies can be to strengthen private sector initiatives for activities ranging from infrastructural improvement and financial intermediation to healthcare, social safety programs and education.

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