An agenda for equipping budgets to achieve the SDGs

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Across the Arab region, reforms in both mobilizing revenues and spending for social purposes can drive a virtuous cycle of inclusive growth, decent work and poverty reduction. They can guide smart investments in economic transformation and social capital that many countries must make to attain the SDGs. Public social expenditure plays an essential role in enhancing the social welfare and economic potential of individuals. As revealed during the COVID-19 pandemic, it also protects poor and vulnerable populations and buoys small businesses during downturns.

Managing budgets equitably, efficiently and effectively, however, has remained a major challenge for most Arab Governments. This is due to low-quality monitoring, ineffective coordination among ministries and a lack of effective PFM. It also stems from shortfalls in political vision and will that have often favoured short-term fixes over longer-term investments leading to more inclusive societies and robust economies.

With already limited fiscal space under intense pressure from the demands of the COVID-19 pandemic, Arab countries now face difficult questions around social expenditures. Based on the findings of the SEM, this report stresses that in some cases there is a need to spend more but that much could also be achieved by spending smarter, building on more efficient and equitable spending choices.

The following 11-point agenda for action offers some general starting points that can be tailored to specific national circumstances. It calls for Governments to take the lead but also for international support to help strengthen capacities and develop tools to enhance fiscal space for social expenditures. Civil society has a critical role in deepening research on social expenditure equity, efficiency and effectiveness; conducting social policy evaluations; and recommending ways to improve policy choices and outcomes.

A. Reprioritize public budgets and increase allocations to critical social policy areas

Governments need to consider a balanced mix of expenditures. In many cases, this will involve increasing public transfers to targeted social protection programmes addressing poverty and vulnerabilities and investing in improved human capital and economic growth. There are two main priorities.

First, several social policy areas have remained at the margins of public budgets, such as expanding capacities among youth, particularly through art and sports, and increasing research and development. Labour market support is also limited, such as through employment generation programmes, incentives for start-ups, support to small and medium enterprises, and female employment. Another concern entails building resilience among the most vulnerable, including through early childhood development and social insurance for informal workers. Environmental protection programmes receive short shrift. In each of these areas, budget expenditure is less than 1 per cent of GDP, which severely undermines the effectiveness of public programmes. It often leaves poor and middle-class people at the mercy of costly private-sector service providers.

Second, better targeting of social protection expenditures improves effectiveness and can save resources that can be redirected to marginalized areas of social policy. Social protection expenditures comprise up to 16 per cent of GDP in some countries but largely entail inefficient and often unfair subsidies for fuel and electricity. Rationalizing subsidies can potentially free resources although should be done carefully. Subsidy reforms mainly for fiscal consolidation could have a contractionary effect on growth and an adverse impact on social development.

As a general principle, reducing social expenditure and thereby diminishing the quantity and quality of public services can have adverse impacts on tax collection since it tends to break the social contract between States and citizens. In contrast, more effective social expenditure policy tends to draw in more tax revenues, based on global experiences.

B. Enhance social expenditure effectiveness through more allocations to social investments with long-term positive impacts on human development and economic growth

The effectiveness of social expenditure depends on how well each unit of expenditure increases social welfare in the short term and adds to economic growth in the long term. This requires improving and sustaining quality public services and quality infrastructure that catalyse the mobility of people and the workforce. It calls for evidence-based monitoring of social expenditures, policy impact evaluations and assessments of the economic growth multiplier effects of social expenditures. Without the insights gained from these exercises, critical challenges are often ignored.

For instance, cash transfers or public in-kind transfers have a short-run effect in stimulating demand in the economy, in addition to protecting the poor and the vulnerable. These expenditures should not replace investments in human capital that deliver a long-run return by creating a quality labour force and enhancing productivity, however. An average of 80 per cent of social expenditure in the Arab region goes to current expenditures, mainly wages, salaries and public transfers, while only 20 per cent goes to capital expenditures. While rebalancing expenditures requires structural reforms in Arab economies, Governments also need to better balance spending to support short-term needs while making social investments that generate long-term growth.

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C. Improve social expenditure monitoring in all areas that directly support achieving the SDGs, including by applying the SEM

Many Arab countries lack comprehensive monitoring of their expenditures on social programmes, which is an obstacle to understanding how well budget choices contribute to the SDGs. Without quality monitoring, public social expenditure often results in inefficiencies such as allocations to multiple and overlapping programmes or mismatches between expenditures and needs. The SEM can help fill the monitoring gap since it comprises more than 50 indicators in seven dimensions aligned with the SDGs. It goes beyond the traditional emphasis on health, education and social protection to capture social policy areas that are essential, such as the labour market, housing and connectivity, arts and sports, and environmental protection, but that remain on the margins of most public budgets.

D. Make “smart” investments to enhance equity

Arab States have devoted important social expenditures to expanding access to education and health care. Yet, these gains have not reached all members of Arab societies, leaving barriers to equity. Governments need to allocate resources towards services most frequently used by poor and vulnerable populations. This is essential not only to improve development outcomes but also to realize human rights and uphold social justice.

Some issues arise from inadequate social expenditure, particularly when it short-changes public services for the poor and the most vulnerable. A low share of GDP for spending on health and education in the Arab region, compared to international benchmarks, is likely a barrier to equity.

Beyond spending, accurate data on beneficiaries of public expenditure need to improve to better analyse equity. Existing information suggests that households and families benefit from public transfers but it is not clear how equitably distributed these are. One obviously regressive pattern is when significant spending goes towards subsidies used primarily by richer households. Other discrepancies are evident in marginal shares of public expenditures for programmes targeted to women, at 0.1 per cent of GDP on average for the selected countries in the SEM, and specific vulnerable populations (including people living with disabilities, refugees and immigrants), at 0.2 per cent of GDP. Limited coverage of services for children, a lack of social security for workers in the informal sector and insufficient social security for older people not in the formal pension system are other critical shortfalls in targeting public expenditures.

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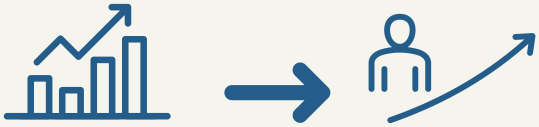

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greater human development gains

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E. Assess the efficiency of public social expenditure to minimize wastage and improve investment in development priorities

Most Arab countries are performing below average in terms of the efficiency of social expenditure. With greater efficiency, to the level of global benchmarks, they could spend the same as a share of GDP and either achieve greater human development gains or channel savings into other priorities. Reaching the global average would free resources amounting to as much as 1.5 per cent of GDP. Increasing efficiency to that of high-income countries would save up to 3.5 per cent of GDP.

In education, for example, low efficiency means that Arab countries reach fewer expected years of education than global peers relative to spending levels. Jordan's overall efficiency in education expenditure is 0.76 compared to the top-performing high-income countries at 0.93. Improved education spending efficiency to meet the high-income country level would boost Jordan's expected years of schooling from 11.5 to 12.1 years.

Many Arab countries are relatively efficient in public social protection expenditure as measured by reducing the undernourishment rate. In reducing poverty, however, inadequate social protection spending, outside subsidies, coupled with inefficient targeting to the poorest and most vulnerable, remain major challenges. Low public social expenditures on health, housing and environmental protection force people to rely on out-of-pocket expenditures and private service providers, with adverse implications for equity and broader development outcomes.

Since insufficient data limit performance assessment of the efficiency of public social expenditure, Governments should seek to improve data systems. These should capture expenditures at disaggregated levels (inputs) and associated performance (outputs), since understanding both is crucial for evidence-based decision-making.

F. Improve fiscal sustainability and deliver quality, inclusive public services

With limited fiscal space, many Arab states face the difficult challenge of spending more without breaking their budgets. This calls for improving efficiency through a combination of policies associated with overall public financial management. Examples include assessing strategic areas of public expenditure with transformational impact, periodic evaluation of public social programmes to identify areas of improvement across ministries, and modernizing the public transfer system to ensure transparent, efficient and quality service delivery, and better targeting to vulnerable populations.

Greater fiscal discipline can come through simulation exercises informing policymakers of how public social expenditure policies align with macrofiscal policies. Countries with more fiscal discipline, measured by stabilizing the Government debt-to-GDP ratio over the medium term and managing the primary balance and fiscal balance ratios, may be more efficient as they watch their expenditures more closely and have more fiscal space to allocate funds where they are needed most.

G. Improve domestic revenue mobilization by increasing tax collection, reassessing the tax base, enhancing tax equity and progressivity, and addressing tax inefficiencies

Several tax reforms in the last decade have aimed to improve revenue mobilization but have not spurred the desired increase in public revenues. This is due, not least, to significant leakages that undermine the integrity of tax systems. Estimates indicate a loss of about $7.5 billion in annual revenues due to corporate tax abuse, for instance. Furthermore, reforms have mostly fallen short in improving tax equity and progressivity.

Across the region, tax systems heavily rely on indirect taxes, which impose a greater tax burden on the poor and the middle class than on the rich. Income tax out of total tax revenue remains low, at 20 per cent at most. Property tax is almost negligible in most cases. In Arab middle-income countries, the median taxes-to-GDP ratio remained at around 16 per cent in 2019, compared to an average of 18 per cent in middle-income countries globally. Regionally, tax revenues as a share of GDP have hovered around 8 per cent since 2010. This is due to the continued reliance of GCC countries on oil for most of their revenues, although some have started imposing value added taxes.

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Improving tax efficiency is another important consideration for most Governments. If this reached the average level of OECD countries, revenues could rise by as much as 45 per cent in some countries. Increasing tax collection should be seen as not just about passing tax reforms alone but about making social investments in quality public services. This in turn builds trust in the Government and creates buy-in among taxpayers.

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H. Work out credible fiscal frameworks over the medium term, for revenues and expenditures

Improving domestic revenue mobilization is essential in many Arab countries but will not be sufficient given the scale of funds required. Fiscal frameworks should consider needs for augmenting existing borrowing or pursuing new borrowing to finance the SDGs and boost economic growth. Medium-term debt-stabilizing scenarios are important in countries still within the bounds of sustainable debt. These should stipulate that debt needs to be channelled to productive sectors to generate growth and improve revenues, and that the share of interest payments to revenues should remain at an acceptable level. Conducive monetary policy should maximize the value of fiscal measures and be closely coordinated with fiscal policy.

Moratoriums on debt service payments under the G20 Debt Service Suspension Initiative are important initial actions that have temporarily helped some least developed countries facing unsustainable debt burdens. But putting payments on pause will not be enough to mitigate debt distress, given the prolonged impact of COVID-19, the emergence of the conflict in Ukraine and the ripple effects through the global economy. Middle-income countries are not eligible to benefit from the initiative even as many carry high debt burdens, and the scope of temporary relief was limited to official creditors with no mechanism for private creditors to participate. The international community and creditor countries need to consider more ambitious and fair methods of debt relief.

I. Operationalize innovative debt relief instruments such as climate and SDG debt swaps to improve financing for public goods

Swaps offer significant opportunities for middle-income Arab States, where external debt servicing consumes about $20 billion of expenditures, equivalent to 11 per cent of their export earnings. In 2022, debt service burden and budgetary pressures increased further due to high interest rates and the spillover effects of the war in Ukraine on food and energy prices. They could alleviate mounting pressures on public finance, enlarge fiscal space and release funds for social and environmental aims.

In 2020, ESCWA launched the Climate/SDGs Debt Swap–Donor Nexus Initiative. This is especially helpful for countries facing tighter fiscal space but not yet unsustainable debt burdens. This initiative creates a next-generation debt swap instrument that considers the scalability of the swap amount, donor support and key performance indicators to maximize impact. It addresses the limitations of traditional swaps mainly implemented ad hoc with limited impact on development objectives. Ultimately, the success of this initiative will depend on the support of donor countries as well as creditor coordination. UNDP's Sustainable Finance Hub (SFH) provides technical support to the development of debt solutions that are linked to SDG specific commitments and indicators such as thematic bonds and debt-for-nature swaps.

J. Developed countries can help bridge the inequality gap in fiscal stimulus between developing and developed countries

This requires fulfilling commitments to finance the SDGs and contribute to an inclusive global recovery. Constrained fiscal space and liquidity challenges are apparent in the Arab region's inability to effectively respond to pandemic fallout let alone jumpstart a resilient recovery. Its fiscal stimulus was low both compared with the global average and given needs arising from dramatic losses in income and jobs. Arab countries allocated only around 4 per cent of GDP to fiscal stimulus in 2020 compared with a global average of 22 per cent. Other issues requiring attention relate to the low share of ODA allocated "on budget" or directly to recipient Government budgets, which limits the more strategic and responsive use of funds. Another proposal is for member States of the IMF to channel unused Special Drawing Rights from advanced to developing countries in the Arab region and elsewhere more effectively, based on indicators of vulnerabilities and financial shortfalls stalling recovery.

K. Develop a carefully designed PFM reform roadmap and tackle key PFM challenges

A PFM reform roadmap entails carefully sequencing reforms that factor in the strengths and weaknesses of existing systems, resources and capacities. Significant PFM system bottlenecks should be prioritized, including assets and liabilities management, accounting and reporting, the legislative role throughout the budget cycle, the independence of supreme audit institutions, expenditure controls, budget transparency, medium-term frameworks, internal audit functions, and payroll and procurement controls for countries with fragile and conflict-affected situations. Reforms should start with core functions for financial compliance, fiscal control and budget reliability as these lay the groundwork for all other PFM functions and reforms. Improved PFM should build on effective medium-term expenditure and revenue frameworks and become more sensitive to development priorities through "priority-based" budgeting. This could be linked to the SDGs, gender equality, children, and climate, among other examples. Across the Arab region, multiple benefits may come from working collectively to share resources to develop PFM, including to develop skills quickly and improve the comparability of financial reporting.