EXECUTIVE SUMMARY

Fiscal space for child-sensitive social protection in the MENA region

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International Policy Centre for Inclusive Growth (IPC-IG)

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FISCAL SPACE FOR CHILD-SENSITIVE SOCIAL PROTECTION IN THE MENA REGION

CONTEXT AND MOTIVATION

Child poverty remains an issue of concern in the Middle East and North Africa (MENA) region. Although the region has made significant progress in reducing extreme poverty and improving health, education and child survival rates, progress has been uneven. Higher-income countries have advanced more than lower-middle-income ones, and those impacted by humanitarian conflicts have seen reversals in child well-being indicators.

In addition to the expansion of the coverage and quality of health and education services, which are clearly lacking, social protection can play a key role in increasing children's human capital and ensuring their most basic rights. Social protection schemes such as child grants, social pensions, social cash transfers and fee waivers can enable families to invest in their children's education, nutrition and health. Providing adequate social protection to children is particularly relevant in MENA, as a large share of the population in the region will soon transition into their most productive age, paving the way for a demographic dividend.

Today, the scope and adequacy of the region's social protection systems remain limited. MENA countries have traditionally relied on universal subsidies and contributory insurance schemes and despite recent reforms in the non-contributory sector, the schemes in place are far from reaching all children in need. The generally low social protection coverage levels in the MENA region call for the need to scale up existing programmes and increase social protection expenditure. Compared to other regions in the world, such as Latin America, public expenditure on social protection—especially for children—is very low in MENA. While many countries scaled up social protection interventions as a response to the 2008 economic crises and the Arab uprisings in 2011, in recent years governments in the region have been more reluctant to do so in a context of fiscal consolidation.

Yet, to achieve the desired positive outcomes such as fostering children's human capital, social protection programmes need to be well-designed across all dimensions. This means that resources are not only required for the actual payments of benefits, but also for programmes' running expenses, including human resources—such as case workers—and the maintenance of management information systems, among others. These elements are particularly important to ensure that social protection systems in MENA are made resilient, integrated with other sectors and able to respond to covariate shocks. Moreover, adequate long-term financing is needed to ensure the adequacy and predictability of benefits, as also foreseen in a human-rights based approach to social protection.

METHODOLOGY

The need to expand social protection in the MENA region leads to the question of how countries can allocate resources to new child-sensitive social protection programmes and/or increase the budget of existing programmes. From this perspective, this study explores the different ways to increase resources allocated to social protection and discusses the main constraints facing each option.

The United Nations Development Committee put together a tool for assessing the different fiscal instruments a government can use to finance a national development strategy, known as the 'fiscal space diamond'. It maps out how to finance development (or, in the case of this study, a comprehensive child-sensitive social protection system) through: (a) external grants in the form of aid or debt relief, (b) domestic revenue mobilisation through improved tax administration or tax policy reforms, (c) deficit financing through domestic and external borrowing and (d) reprioritisation and efficiency of expenditures.

In this study, we propose an adaptation of the fiscal space diamond framework by focusing on the options for countries to raise fiscal space internally, which meant leaving out official development assistance (ODA). Though some countries in the region rely on external aid to finance part of their development expenditures, ODA is not a sustainable solution for fiscal space. However, it can be considered as an initial solution for countries where other options to increase fiscal space are limited, such as Djibouti and Yemen.

As we only use three dimensions of fiscal space, we represent the aggregate fiscal space of each country through a fiscal space triangle instead of a diamond. Each corner of the triangle represents one dimension of fiscal space. The indicator for each dimension of the triangle is a score set between 0 and 1 and is computed so as to give an idea of the country's potential to increase fiscal space through that particular option. Table 1 describes how the indicators were computed for each dimension:

Table 1. Indicators of the fiscal space triangle

Dimension	Formula	Normalisation
Domestic resource mobilisation	$1 - \frac{\text{country's tax revenues as a percent of GDP}}{0.268}$	Each country's tax revenues are normalised by the region's top end (Algeria's tax revenues, equal to 26.8 per cent of GDP).
Deficit financing	$1 - \frac{\text{country's gross debt as a percent of GDP}}{0.4}$	Countries' debt ratios are normalised using a benchmark of 40 per cent debt-to-GDP ratio, which is the limit that the IMF suggests for developing countries. For countries with debt-to-GDP ratios exceeding 40 per cent, the score is negative, but for the visual representation we have set it to zero.
Reprogramming of expenditures	$\frac{\text{country'spending on energy subsidies as a percentage of GDP}}{0.07}$	The indicator is normalised by the 75th percentile of the distribution (equal to 7 per cent of GDP). For countries whose spending on energy subsidies exceeds the 75th percentile, the final indicator is set to 1, although the actual score is above 1.

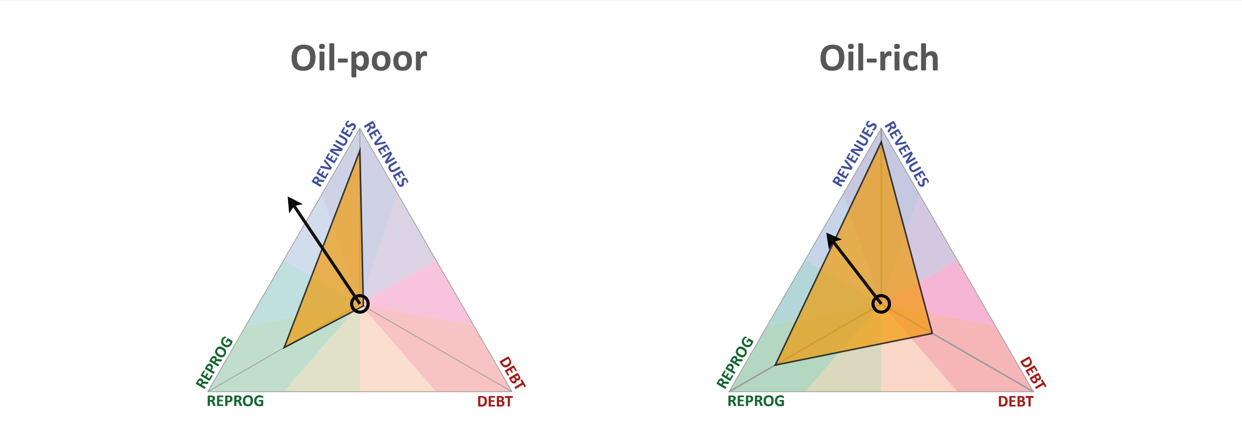
Figure 1 illustrates the fiscal space triangles using the example of oil-poor and oil-rich countries.[1] The size of the internal triangle with a solid colour gives an idea of the overall fiscal space in the country: a large area means that the country has ample fiscal space. Moreover, the corners of the internal triangle indicate the potential for fiscal space in each dimension: The higher the score for a given axis (i.e. the closer the corner of the internal triangle is to the external corner), the greater the potential to increase fiscal space in this dimension. Finally, the arrow in the figure represents the 'path' for the country to create fiscal space. It is set by adding the three vectors of the triangle, which means that one dimension can offset another: a larger arrow indicates a clearer path, whereas a small arrow indicates a less clear solution to increase fiscal space (which can mean that the country has many options to do so, as the sum of three large vectors will also result in a smaller arrow).

In the example above, it possible to see that oil-rich countries have, on average, greater potential for fiscal space overall (the area of the internal triangle is larger than for oil-poor countries) and in each dimension (the corners are closer to the external triangle). For both categories of countries, the arrow points towards a mix between domestic revenue

1. Oil-rich countries are: Algeria, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia and the UAE. Oil-poor countries are: Bahrain, Djibouti, Egypt, Jordan, Lebanon, Morocco, Tunisia, Sudan and Yemen. The fiscal space triangles for oil-poor and oil-rich countries were elaborated by aggregating the indicators for each category (computing the simple average across countries).

mobilisation and reprogramming of expenditures as ways to increase fiscal space. The arrow is larger for oil-poor countries (indicating a clearer path) because they are more restricted regarding debt financing than oil-rich countries.

Figure 1. Fiscal space triangles: examples of oil-poor and oil-rich countries



Source: Authors' elaboration.

MACRO-FISCAL CONTEXT OF MENA COUNTRIES

When assessing the capacity of MENA countries to allocate more resources for expanding child-sensitive social protection expenditures, it is important to keep in mind that these countries vary substantially with regards to natural resources endowment, size of their economy and fiscal constraints:

Gulf Cooperation Countries (GCC) are classified as high-income and have a favourable macro-fiscal context, as they benefit from oil rents and their level of debt is generally very low. They have the potential to increase tax revenues, given their low rates expressed as a percentage of GDP.

Algeria, Iran and Iraq are upper middle-income countries that seem to be in a more comfortable situation as they benefit from oil rents and have relatively low debt-to-GDP ratios. Algeria has the highest tax revenues (as a share of GDP) of the region, while Iran and especially Iraq have lower levels. Lebanon and Jordan, on the other hand, are in the same income category but they do not export oil, relying more on tax revenues to finance government expenditures, and have very high debt ratios.

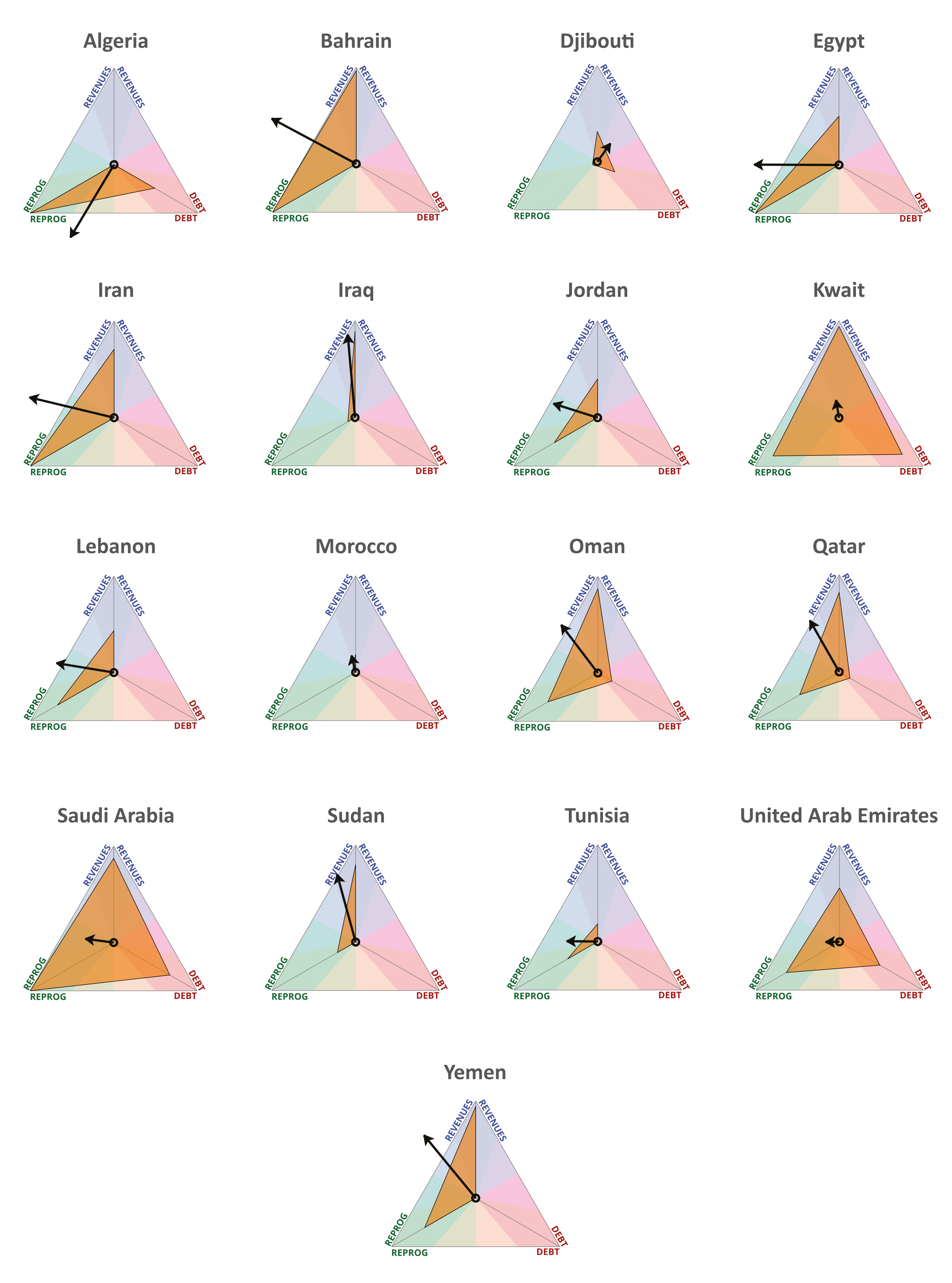
Djibouti, Egypt, Morocco, Sudan and Tunisia are in the lower middle-income category. Many of these countries are constrained by high debt ratios, especially Egypt and Sudan. Tunisia, Morocco, Djibouti and Egypt have higher tax revenues than average for the region, while Sudan has the lowest share of tax revenues among oil importers.

Yemen and other countries not included in the report (Libya, Syria and Palestine) have specific development challenges, as they are facing major conflicts and deterioration of infrastructure, which severely undermines the countries' ability to mobilise domestic resources.

RESULTS AND FINAL RECOMMENDATIONS

Figure 2 presents the fiscal space triangles for 17 countries in MENA, highlighting the myriad fiscal space challenges and opportunities: while some enjoy a favourable situation in different dimensions, other countries seem to have limited options for increasing fiscal space.

Figure 2. Fiscal space triangles for MENA countries



Source: Authors' elaboration.

Fiscal space depends on the adequacy of revenues to finance expenditures. Since social protection for children requires stable and important sources of financing, MENA countries could consider the option of creating fiscal space through sustainable and equitable revenue mobilisation.

Tax policy reforms in MENA over the past two decades have had a marginal impact, suggesting that more fundamental reforms should be considered, particularly in the area of income and wealth taxes, as they constitute a negligible share of total tax revenues in the region.

In addition to freeing up resources to invest in social policy for children, these reforms could contribute to the reduction of inequality in MENA countries if they take place in the context of a progressive tax. Moreover, enforcement of fiscal policies is still a problem in many countries of the region, since governments struggle with the strong share of informality and tax evasion by persons and corporations. Policies aiming to improve the efficiency in collecting and managing fiscal resources could therefore come as a complement to MENA governments' efforts to increase tax revenues. Increasing the progressivity of tax systems (particularly personal income taxes), enforcing property taxes, strengthening tax administration and eliminating exemptions will be key to improving equity and will facilitate compliance and administration.

An analysis of the fiscal space triangles shows that many countries have room for increasing tax collection. The option of increasing tax collection to finance child-sensitive social protection is particularly recommended for GCC countries and for those with high debt-to-GDP ratios and low tax revenues, such as Iraq, Iran and Sudan.

Another way to achieve inclusive fiscal consolidation is to address equity, efficiency and effectiveness issues on the spending side of the budget, including better-targeted and more cost-efficient government expenditures. Energy subsidies—proven to be costly and regressive investments—continue to capture a disproportionate part of social expenditures in most countries of the region. Subsidy reforms are, therefore, a common policy recommendation from international organisations.

However, since the implementation of social policies takes time, subsidy reforms need to be carefully planned in advance. Compensatory measures should be in place concomitantly with the phasing-out of subsidies, considering the negative social impacts (such as sudden price increases) that will disproportionately affect poor and vulnerable households. Some countries such as Egypt, Iraq, Jordan, Morocco, Tunisia and Sudan have recently started reforms to move away from universal food and energy subsidies towards more targeted forms of social assistance, such as cash transfers.

The high scores in the dimension of reprogramming for Iran, Egypt, Algeria, Bahrain and Saudi Arabia suggest that these countries have the most potential to free up resources through subsidy reforms. However, it seems important to highlight that excessive spending on high-cost and low-impact policies is a problem that affects the entire region, which means that all countries should consider reprioritising expenditures as an option to increase fiscal space for child-sensitive social protection. All government expenses that seem excessive should be carefully evaluated to identify inefficiencies and redirect funds to higher-impact expenditures. In this sense, efforts to increase transparency and accountability would also increase efficiency in gathering data, assessing budget allocations and evaluating existing policies.

Finally, as increasing tax collection and reprogramming expenditures require structural reforms, they might take longer to become sustainable sources of revenue to finance child-sensitive social protection. MENA countries can therefore consider additional options to enhance fiscal space in the short and medium terms:

- Some MENA countries, such as Kuwait, Saudi Arabia, Algeria, UAE and, eventually, Djibouti, seem to have enough room to increase fiscal space through deficit financing, as they all have debt ratios around 30 per cent of GDP or below.

- Natural resources are important sources of revenue for many governments in the region. However, these resources are vulnerable to price fluctuations, as illustrated by falling global oil prices and the evolution of oil rents that followed. Oil rents could be an interesting option to establish and feed sovereign wealth funds, as governments could draw from these funds to invest in social protection to realise higher levels of growth in future.

- One way to mobilise additional domestic resources is by integrating revenues from Waqf and *zakat* into the formal social protection system, though this may come with challenges in terms of coordination and transparency (case of Sudan).

- ODA can be considered a starting option for countries where other options would require significantly more time, such as those with lower levels of development or that have been affected by conflict. The main challenge of as pertaining to social protection regards how it can contribute towards durable solutions that can enhance social protection systems in the long term. In this sense, ODA could help finance programmes as part of an emergency response and support a future expansion of social protection coverage based on other fiscal space pillars to ensure sustainability.

It seems important to highlight that as every country has its own development model, they differ regarding the design and scale of their social protection programmes; therefore, so does the level of resources needed and the possible options for expanding them. Governments can consider the different ways proposed in this report to expand child-sensitive social protection and adapt them to their specific contexts, keeping in mind that increasing fiscal space is inherently linked to a country's political will, its policy priorities and other factors beyond government control, such as macroeconomic imbalances caused by external shocks. Therefore, it is important to consider the specificities of each country when assessing their fiscal space options. In this sense, MENA governments should weigh up long-term benefits of child-sensitive social protection against the short-term objectives of fiscal consolidation.

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