



# Fiscal Space & Public Expenditure on the Social Sectors

Until the onset of the global economic crisis, higher growth, tax revenues and aid flows improved public finances across much of West and Central Africa. Rising commodity prices, along with more prudent fiscal policies and debt relief, helped to boost revenues and reduce previously large deficits. In the franc zone countries, for example, the aggregate overall fiscal balance (including grants) improved from an average deficit equivalent to -1.4% of GDP in 1997-2002 to an average surplus of 4.0% of GDP in 2003-2007, according to IMF data.

Paradoxically, this did not bring about a large increase in public spending on the social sectors to accelerate progress towards the Millennium Development Goals (MDGs), despite the commitments to do so in most Poverty Reduction Strategy Papers (PRSPs). In fact, most governments deliberately restrained public expenditure from growing as fast as the rise in revenue and aid, in order to reduce their deficits.

The situation has varied widely among countries, with oil producers benefiting from the surge in oil prices in 2004-2008, while some 'fragile' states have been severely affected by conflict or governance problems.

Since 2008, there have been serious setbacks, due first to the steep rise in food and fuel prices (except in the oil producers) and then the adverse shocks

from the global economic crisis, including sharp falls in the prices of the region's main export commodities. The crisis is also expected to result in substantial falls in remittances, private capital flows, and official development assistance (ODA).

## Box 1. The study on children, PRSPs & budgets in West and Central Africa

This is one of eight briefing papers that present the main findings of a study on children, PRSPs and government budgets in West and Central Africa. The objective of the study was to deepen understanding of the impact on children of the PRSPs, the evolving fiscal environment and related reforms in public financial management systems and aid modalities in West and Central Africa.

Commissioned by UNICEF's West and Central Africa Regional Office (WCARO) and carried out by Oxford Policy Management (OPM) between November 2007 and February 2009, the study included a regional review and five country case studies on Burkina Faso, Chad, Ghana, Mauritania and Sierra Leone.



### Box 2. What is fiscal space?

The concept of 'fiscal space' refers to the flexibility (or 'room') available to a government to adjust elements of its budget in order to increase spending, either overall or in some priority area such as, for example, basic social services for children. Fiscal space can arise from any of the following:

- an increase in domestic revenue, such as higher tax revenue;
- an increase in grants;
- an increase in borrowing, whether domestic or foreign;
- an increase in fiscal deficits not matched by formal borrowing, implying either inflationary financing or payments arrears;
- a shift in the sectoral, sub-sectoral or geographical composition of expenditure;
- greater efficiency in the use of public funds, implying that more units of service are produced per unit of money expended.

Since the region consists mainly of low income countries, it is not easy to create significantly more fiscal space in any of these various dimensions. The main exception in the region has come from sudden large increases in revenue from oil or mining.

Long term sustainable success in expanding fiscal space depends mainly on improvements in tax revenue or spending efficiency.

Increased aid is another source of fiscal space, but aid is unpredictable and over-dependence on aid carries risks. Modest borrowing is a viable option but, if carried to excess, deficit financing can create an unsustainable debt burden, fuelling inflation and crowding out private sector borrowing. This in turn can undermine growth, reduce future fiscal space and ultimately be harmful to poverty reduction and child wellbeing.

### Fiscal space

Up to 2007, the reduction in overall fiscal deficits in the region was impressive. 17 out of 23 countries succeeded in reducing their overall deficits (before grants) between 1997-2002 and 2007. Seven achieved surpluses in 2007, and this number rises to 13 if grants are taken into account, compared with only three countries in 1997-2002. The number of countries with overall deficits (including grants) of more than 5% of GDP dropped from eight to four over this period. This suggests that there was a significant improvement in fiscal space in the West and Central African region (see box 2).

Three factors explain this major improvement. First, all but two of the countries succeeded in increasing domestic revenue as a percentage of GDP. Across the region, this averaged 21.2% in 2007, compared with 15.6% in 1997-2002. The situation improved dramatically in six countries that raised their revenue/GDP ratio by more than 8 percentage points, in most cases due to large increases in oil or mineral production: Chad, Congo, DRC, Equatorial Guinea, Liberia, and São Tomé and Príncipe.

There is a large variation in countries' revenue take, from lows of 10-11% of GDP (CAR and Sierra Leone) to highs of around 40% in oil producers such as Congo and Equatorial Guinea. Some countries could increase their fiscal space significantly by improving domestic revenue mobilization towards the level of the better performers.

Second, ODA to the region rose by the equivalent of about 1% of GDP between 2000 and 2006. Some countries gained much more than others, mainly because most of the increase came from debt relief, which between 2000 and 2007 benefited in particular 12 of the countries (Benin, Cameroon, Congo, DRC, Côte d'Ivoire, Ghana, Mali, Mauritania, Niger, Nigeria, Senegal and Sierra Leone). Several fragile states (CAR, Chad, The Gambia, Guinea, Guinea-Bissau, Liberia, São Tomé and Príncipe and Togo), as well as the two wealthiest oil producing countries (Equatorial Guinea and Gabon) did not benefit from debt relief during this period.

# social exclusion

## reduction of poverty

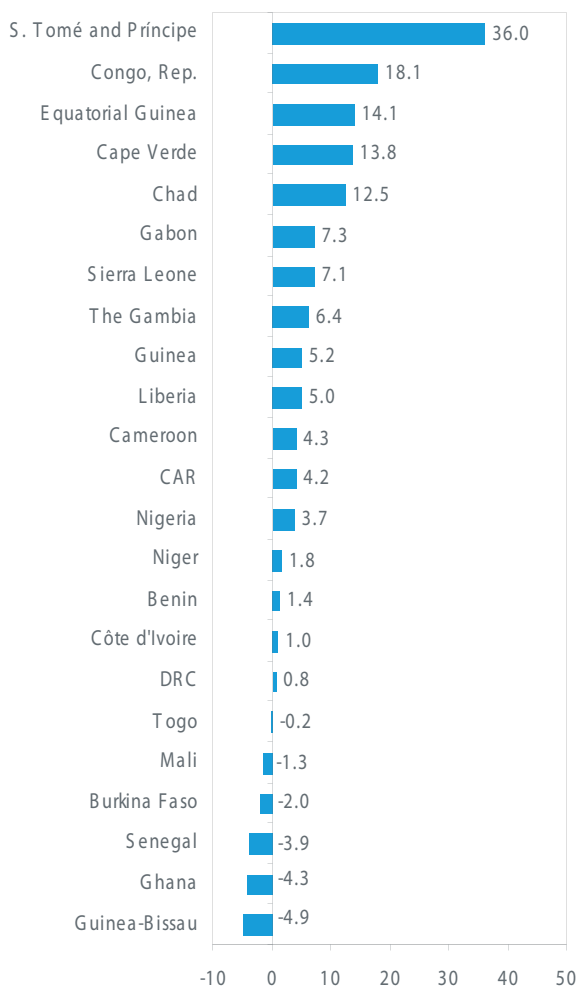
Third, most countries converted only part of their revenue and aid gains into expenditure increases, and in some cases actually reduced expenditure as a percentage of GDP. While the average revenue gain was 5.9% of GDP, only about 0.5% of this was used to increase expenditure. Eight countries did not make any increase at all in their expenditure/GDP ratios. There were particularly large declines in these ratios

(more than 5 percentage points of GDP) in Cape Verde, Gabon, Nigeria, São Tomé and Príncipe, and Sierra Leone. Box 3 highlights the case of Nigeria.

Given the favourable trends in revenue and aid, should countries have expanded expenditure more? Was an opportunity lost to increase public expenditure sharply to accelerate progress towards the MDGs? Overall the evidence suggests that more than half the countries needed to reduce their deficits, which were unsustainably high in 1997-2002. Most of the largest deficit reductions took place in the countries that had the highest deficits (more than 7% of GDP) in 1997-2002.

However, three countries with initial deficits above 10% of GDP (Guinea-Bissau, Burkina Faso and Ghana) failed to make any reductions. And, at the other extreme, three countries with initial surpluses (Gabon, Liberia and Equatorial Guinea) chose to increase their surpluses.

**Figure 1. Improvement in overall fiscal balance (before grants), 1997-2002 to 2007 (% of GDP)**



Source: IMF, Regional Economic Outlook, Sub-Saharan Africa, October 2008.

### Social sector expenditure

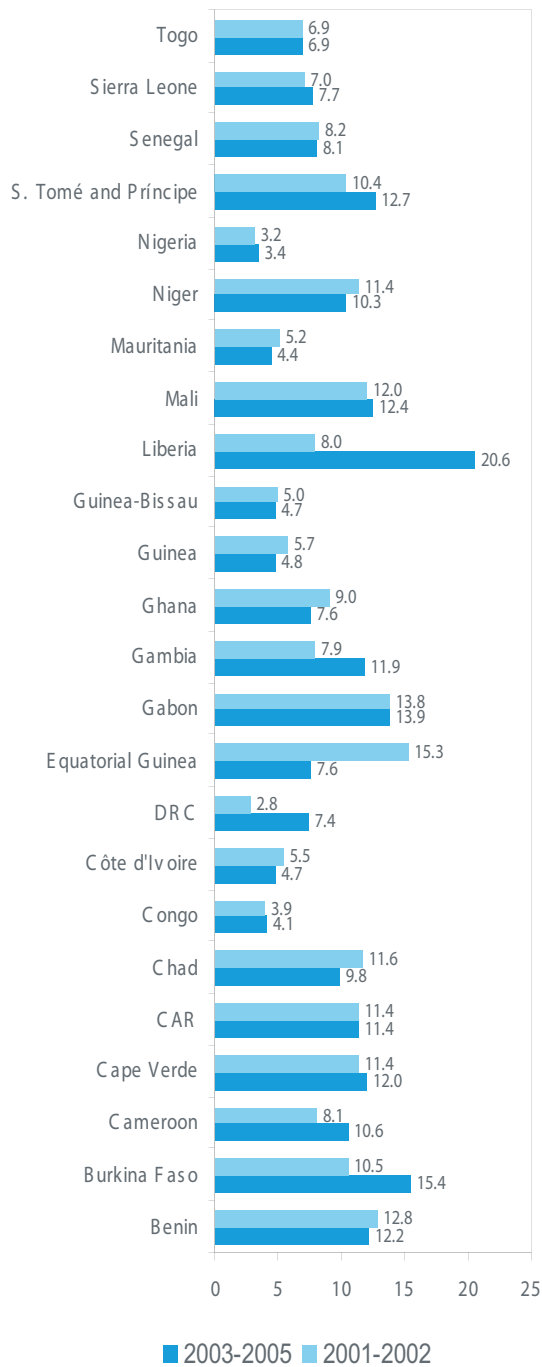
How did social sector expenditures fare in this context? The policy setting was clearly favourable, as most PRSPs explicitly envisaged increases in the respective shares of education and health in government expenditure.

### PRSP commitments

In the case of health, PRSPs have tended to project modest increases in the ratio of health expenditure to total government expenditure. But some countries' PRSPs have projected much larger health shares of government spending than in other countries. In the first generation PRSPs, these ratios were three times higher in Benin and Mauritania than in Mali and Cameroon.

The PRSPs have also projected increases in education spending in most countries - considerably so in Cape Verde, the DRC and Niger. Again, however, there have been large inter-country differences in the degree of prioritization, with especially large education/GDP ratios projected in Cameroon, Mauritania and Niger. In some cases, these projected figures are so high that their credibility is open to question.

**Figure 2. Health share of total government expenditure (%)**



Source: WHO Statistical Information System.

**Actual expenditure**

Data limitations make it extremely difficult to compare countries’ performance on social sector expenditure in practice. The available data, published by WHO for health and UNESCO for education, which in turn are reproduced by the World Bank, are either outdated (health) or have major data gaps (education), and are often inconsistent with in-country data.

The very limited regional education expenditure data provide no clear trends. For example, Cameroon shows a sharp increase in 2001-2003, falling slightly thereafter, while Congo shows a significant decline from 2001 to 2005, and expenditure in Mali has oscillated, with no clear trend. The slight decline in the share of education in government expenditure in Cameroon in 2004-2006 contrasts with the PRSP projections of a substantial increase: by 2006, actual expenditure was 16.8% compared with a PRSP target of 20.5%. In Mali, by contrast, actual expenditure in 2005 (14.8%) was higher than projected in the PRSP (12.5%).

As a share of GDP, education expenditure varies considerably across the region, from less than 2% in countries such as Chad, Congo and Guinea, to highs of 5.0% in Senegal, 5.4% in Ghana and 6.3% in Cape Verde. This suggests that some countries could give much higher priority to education than they do at present: merely by matching the performance of other countries.

In annual per capita terms, very few countries spend more than \$25 on education (examples of those that do are Cameroon, Congo, Ghana and Senegal). Several countries spend less than \$10 per capita. But there is one striking outlier, Cape Verde, which spends more than \$120 per capita.

There are likewise large inter-country differences in health expenditure. On average, over the three years from 2003 to 2005, health expenditure amounted to less than 5% of total government expenditure in Congo, DRC, Guinea-Bissau and Nigeria. In another eight countries, the health share of government expenditure was in the 5-10% range. Only two countries have exceeded the African Union’s Abuja Declaration target of 15%: Burkina Faso and Liberia.

Per capita government expenditure on health is generally low across the region, but with large differences between the low income countries, almost all of which spend less than \$25 per capita, and the wealthiest oil producers, Gabon and Equatorial Guinea, which spend more than \$150 per capita. There are some striking outliers, notably Congo, which has the third highest GDP per capita in the region but spends about the same per capita as very poor countries like Burkina Faso and Mali.

Over the region as a whole, the unweighted average share of health in total government expenditure declined slightly from 9.4% in 2001-2002 to 8.6% in 2003-2005. Although this is a somewhat early period to judge the impact of PRSPs, it suggests that PRSPs initially had little impact on the health shares of government spending in the region as a whole, despite their prioritization of the social sectors.

Finally, it may be noted that high military expenditure was a factor limiting fiscal space for social sector expenditure in some countries, as Box 4 discusses.

### Conclusions

Overall, the region saw a major improvement in public finances prior to the global crisis, although almost half of the countries studied still had overall fiscal deficits as of 2007. Although the situation varied among countries, the general trend was one of rising domestic revenue accompanied by increased aid (concentrated particularly in the countries receiving debt relief) and by restraint in expenditure to restore fiscal stability.

As a result, while expenditure rose in absolute terms in almost all countries, its share of GDP rose only modestly and in several countries declined.

This affected social sector expenditure, which, despite the priority accorded in the PRSPs, generally did not increase as a percentage of total government expenditure, at least up until 2005-2006. Wide variations across the region suggest that some countries could improve the fiscal space for social sector expenditure by improving revenue mobilization and/or by devoting higher priority to the social sectors in the composition of public expenditure.

### Box 3. Restrained spending in Nigeria

As the most populous country in the region, Nigeria is of particular interest. It is also one of the countries that has benefited most from debt relief in recent years.

In spite of its oil wealth and high oil prices up to mid-2008, Nigeria's revenue relative to GDP has been declining. But it succeeded in converting an overall fiscal deficit in 1997-2002 into large surpluses in 2004-2007. This was made possible partly by substantial debt relief, which reduced Nigeria's public external debt from 41% of GDP in 2004 to only 2.4% in 2006. The authorities built up huge international reserves, which stood at \$23 billion by the end of 2007.

In addition, the government restrained the growth of expenditure, which fell by 7 percentage points of GDP between 1997-2002 and 2007. By 2007, Nigeria had a substantially lower government spending ratio (15.8% of GDP) than most other countries in West and Central Africa. The average for the franc zone countries, for example, was 21.9% in the same year.

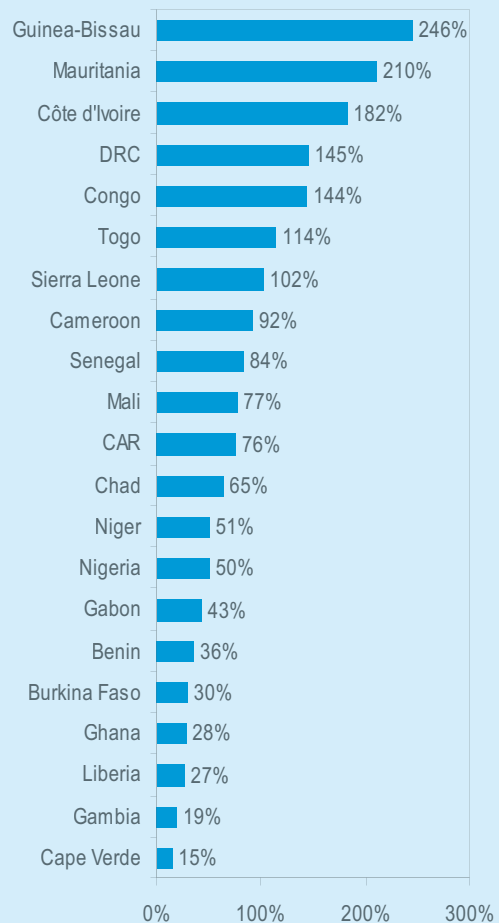
This expenditure restraint affected the social sectors. WHO data indicate that the health share of government expenditure remained stable at less than 4% in 2000-2005. This was equivalent to only 1.2% of GDP, which is low even by the standards of the West and Central African region.

**Box 4. Does military spending crowd out the social sectors?**

Several governments in West and Central Africa spend heavily on defence to address real or perceived security threats. Others spend much less. To assess the potential trade-offs with the social sectors, Figure 3 shows military expenditure as a percentage of health expenditure for 21 countries in the region with available data.

Seven of the 21 countries have levels of military spending in excess of their government health outlays. These are Congo, DRC, Côte d’Ivoire, Guinea-Bissau, Mauritania, Sierra Leone and Togo. Five other countries (Cameroon, Chad, Mali, Niger and Senegal) have levels of military expenditure that are close to their outlays on health. In eleven other countries, military expenditure is quite small in both absolute and relative terms, typically in the range of 0.6% to 1.2% of GDP. These statistics indicate a potential in about half the countries to shift substantial resources from defence and security to the social sectors.

**Figure 3. Military expenditure as % of health expenditure, 2005**



Sources: IMF, International Financial Statistics; WHO Statistical Information System.

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