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FISCAL SPACE FOR CHILDREN AND HUMAN CAPITAL IN EASTERN AND SOUTHERN AFRICA:

OPTIONS AND STRATEGIC ENTRY POINTS TO ADDRESS INVESTMENT GAPS IN 16 COUNTRIES



Fiscal Space for Children and Human Capital in Eastern and Southern Africa:
Options and Strategic Entry Points to Address Investment Gaps in 16 Countries

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This report presents the main findings from the application of fiscal space and political economy analyses in 16 countries in the Eastern and Southern Africa region. Commissioned by UNICEF ESARO, the project was intended to strengthen UNICEF's advocacy efforts by providing a better understanding of the dynamics of investing in children and human capital. The country studies were carried out by Ecorys, in partnership with DNA Economics, between 2016 and 2018.

The project was designed and managed by the Social Policy Section in UNICEF ESARO, led by Jean Dupraz and Matthew Cummins. A team of Ecorys staff and consultants carried out the country studies. The project was headed by Ecorys Project Director, Ivo Gijsberts, and involved the following Ecorys consultants: Andrea Dijkstra, Dafina Dimitrova, Oskar de Roos, Alessandro Ramella Pezza, Jonathan Wolsey, Jan Willem Knippels, Tobias Broich, Herwig Cleuren, Corrado Minardi and Gabriele Pinto, along with Ecorys associate experts Paul Beckerman, Soren Kirk Jensen and Poorva Karkare. DNA Economics carried out five of the studies, which involved the following consultants: Amanda Jitsing, Dawid Pienaar, Fouche Venter and Khethiwe Mavundla. Local consultants were also recruited to support the field work in all 16 countries.

TABLE OF CONTENTS

CHAPTER 1. INTRODUCTION	13
CHAPTER 2. FISCAL SPACE FOR CHILDREN AND HUMAN CAPITAL IN EASTERN AND SOUTHERN AFRICA	15
2.1 Background to the country studies	15
2.2 Framework for assessing fiscal space	18
2.3 The economic context	19
2.4 Expenditure on human capital	23
2.4.1. Definitions and budget classification issues	23
2.4.2. Human capital expenditure trends	23
2.4.3. Human capital expenditure challenges	25
2.5 The outlook for human capital expenditure	28
2.6 Options to expand fiscal space in 16 ESAR countries	30
2.6.1. Increasing government revenue	30
2.6.2. Increasing ODA	34
2.6.3. Reprioritizing spending	36
2.6.4. Improving the efficiency of spending	39
2.6.5. Borrowing and debt restructuring	43
2.6.6. Using fiscal savings	48
2.6.7. Capturing and/or preventing illicit financial flows	49
2.7 Regional and country perspectives on fiscal space in ESAR	52
CHAPTER 3. THE POLITICAL ECONOMY OF BUDGETS IN ESAR	58
3.1 Background to the country studies	58
3.2 The political economy context of the budget	59
3.3 Key dynamics and actors in budget processes	60
3.3.1. Budgeting dynamics	60
3.3.2. Budgeting actors	62
3.4 Advocacy entry points	64
3.4.1. Strategic planning	65
3.4.2. Budget preparation	67
3.4.3. Budget approval	69
3.4.4. Budget execution	70
3.4.5. Budget transparency and accountability	71

CHAPTER 4. CONCLUDING THOUGHTS	74
4.1 The outlook for expenditure on human capital	74
4.2 Options to boost expenditure on human capital	74
4.3 Fiscal space headwinds	75
4.4 Opportunities for UNICEF to influence the investment climate	76
4.5 The final thought	78
ANNEX 1. STEPS TO CARRY OUT THE FISCAL SPACE PROJECTION EXERCISES	79
ANNEX 2. METHODOLOGY FOR STANDARDIZING THE MACRO-FISCAL PROGRAMMING MODELS	82
Adjustments to the baseline scenarios	82
Adjustments to the alternative scenarios	83
Caveats	84
ANNEX 3. FISCAL SPACE COUNTRY PROFILES: THE METHODOLOGY	86
REFERENCES	88

EXECUTIVE SUMMARY

UNICEF's Eastern and Southern Africa Regional Office (ESARO) initiated a multi-country initiative to better understand the dynamics of investing in human capital. The project sought to identify potential opportunities for governments to increase expenditure on the sectors that matter most for children and to close critical investment gaps while maintaining fiscal sustainability (through fiscal space analyses), as well as to pinpoint entry points for UNICEF to more effectively influence government spending decisions (through political economy analyses). In total, fiscal space and political economy analyses were carried out in 16 countries in the Eastern and Southern Africa region (ESAR) between 2016 and 2018. Drawing on information from the country studies as well as from global databases, four key findings emerge.

The first finding is that investment in core human capital sectors is expected to slightly decrease in ESAR in the near term, but that there are significant variations across countries. Based on information from the macro-fiscal programming models that were developed for each country, real per child expenditure was projected to decline by an average of about 6 per cent over five-year periods. At country level, however, the outlooks were very diverse. Five countries were projected to undergo deep contractions in real per child expenditure (between 10 and 30 per cent) and three to have smaller declines (in the 2-5 per cent range), while modest increases (around 3.5 per cent) were forecast in two countries and substantial rises (between 20 and 90 per cent) in six countries.

The second finding is that all countries have at least one very strong option to create fiscal space in support of greater investment in children and human capital in the near term. Seven categories of fiscal space were assessed. These included: (i) increasing government revenue; (ii) increasing official development assistance (ODA); (iii) reprioritizing spending; (iv) improving the efficiency of spending; (v) borrowing; (vi) using fiscal savings; and (vii) capturing and/or preventing illicit financial flows. The application of a simple classification system based on available information suggests that, on average, countries have around three high-potential and two medium-potential categories that could merit further exploration at country level. One group of countries – Botswana, Malawi, Rwanda, Uganda and the United Republic of Tanzania – were identified as having at least four high-potential categories available, while Angola, Kenya, Lesotho, Namibia and Zambia were found to have three each.

Reprioritizing the budget, increasing revenue and addressing spending inefficiencies are the most promising avenues to expand fiscal space in the region. The country projections showed reprioritization to have the biggest potential returns, increasing real per child expenditure by around 6 per cent a year above the investment levels predicted by the business-as-usual scenarios over the near term. Overall, this approach was found to have high potential in 13 of the countries studied. In terms of revenue, while most countries are expected to benefit from natural growth, rising prices and bigger populations will minimize the impact of larger budgets on the development of human capital. However, the low capacity to extract taxes from the economy observed in most countries underscores opportunities for domestic resource mobilization, especially through improved tax administration. Many of the modelling exercises also demonstrated the positive impacts of increasing the efficiency or rates of value added tax, as well as personal and corporate income taxes, on human capital expenditure. Lastly, a review of budget execution and credibility rates in the education and health sectors revealed the severity of one type of spending inefficiency across countries, indicating that the removal of bottlenecks could significantly boost actual levels of investment in core human capital areas in many contexts.

Advocating for more ODA and cracking down on illicit financial flows also appeared as good options to augment fiscal space in sub-groups of countries. On the foreign aid front, if governments – especially in low-income countries – can convince donors that additional resources will deliver strong value for money and be accompanied by robust accountability mechanisms, they should be able to make a compelling case for more grants and concessional loans, given the existing human capital deficits. Meanwhile, the estimated magnitude of illicit financial flows is staggering in many countries, and any actions that can prevent, capture and effectively tax these resources could go a long way toward increasing expenditure on human capital.

Other options did not show strong potential for generating fiscal space. For example, all 16 governments have spent far beyond their means in recent years, which has led to extraordinary debt accumulation. The prevailing debt distress concerns coupled with the difficulties of borrowing to invest in social sectors – which only generate returns over long horizons – make this an unlikely pathway for most governments. At the same time investing fiscal savings that are stored in sovereign wealth funds could be a viable option in the distant future for the group of countries that are expected to become significant natural resource exporters. However, questions surrounding the timelines for and management of future revenues remain too great at present for this to be a realistic near-term consideration.

The third finding is that each fiscal space opportunity faces strong headwinds. For instance, increasing the budgetary priority given to human capital sectors requires competing against other agendas as well as non-negotiable spending items, such as debt repayment, which is ballooning in many places. In terms of revenue, real GDP growth will likely continue to disappoint in most places, which limits the easiest way to raise investment in human capital – natural revenue growth. At the same time, improving tax administration is a long-term process that is unlikely to yield significant near-term gains. Similarly, there are no easy fixes to the multitude of technical challenges that prevent human capital budgets from being efficiently and fully utilized. Turning to ODA, free and/or cheap money should always be a good thing, but over-dependence and the persistence of parallel systems have serious development consequences, while the recent commitment among donors to better target ODA to the poorest countries will increasingly restrict eligibility in the region. And improving tax enforcement capacity and stifling corruption are the main solutions to handle and tax illicit financial flows, both of which are very difficult in practice.

The fourth finding is that there are many entry points for UNICEF to support the scaling up of investment in sectors that are foundational to child well-being. In the formulation phase of the budget cycle, UNICEF can influence national dialogue by delivering strategic messages on the importance of investing in human capital – including through investment cases – while also integrating children's needs into key budget planning documents. At the sector level, supporting the costing of strategies and plans is essential for identifying resource gaps and making a strong case for greater allocations, which is often not done or not done well. There are also openings to help social sector ministries develop stronger budget proposals, as well as to facilitate discussions with finance ministries around their budgetary needs. These efforts can be further complemented by research and advocacy on reorienting the budget and channelling new revenue flows to support greater funding for human capital. At the approval phase, the parliament, which is a partner that is often unexploited by UNICEF in its public finance work, can benefit from support to scrutinize the draft budget and identify funding gaps, training to enhance knowledge of how the budget affects children, and efforts to institutionalize the production of routine budget analyses. The budget execution phase is arguably one of UNICEF's greatest opportunities to contribute to fiscal space, which can be achieved by diagnosing and removing budget execution bottlenecks. Lastly, given that advocacy for greater funding ultimately hinges on having access to reliable information and discussion platforms, UNICEF offices can

continue their efforts to support improved budget transparency and accountability practices across the budget cycle, which can also help governments be better positioned to attract greater ODA flows and borrow.

Fiscal space for children and human capital is a big challenge. Identifying an opportunity is one thing; creating fiscal space in practice – that is, overcoming the headwinds – and then transforming it into greater investment in human capital sectors – that is, influencing the politics that underlie budget allocation decisions – are entirely different and complex processes. Nonetheless, the critical starting point is to understand the likely human capital investment trajectory. And while the modelling exercises suggested mixed outcomes, the very low human capital bases in all countries mean that maximum efforts should be devoted to increasing expenditure as quickly as possible. UNICEF’s quest is therefore to influence that trajectory.

The country studies offer a strategic road map. In all the contexts, the fiscal space analyses identified at least one category that shows strong potential over the near term. From here, it is important to update and re-evaluate those promising scenarios, and to develop a plan to operationalize the best ideas. As revealed in the political economy analyses, although daunting, country offices can navigate forward by adapting to the dynamics of the budget process. They can also pursue multiple strategies, recognizing that small amounts of fiscal space from different sources can significantly alter the investment trajectory and – if well used – transform children’s lives and the economic and social outlooks of their countries.

List of abbreviations and acronyms

AIDS	acquired immunodeficiency syndrome
CI	Composite Index
CIT	corporate income tax
CPI	consumer price index
CPIA	Country Policy and Institutional Assessment
CSO	civil society organization
DP	development partner
DSA	debt sustainability assessment
ECD	early childhood development
ESAR	Eastern and Southern Africa region
ESARO	Eastern and Southern Africa Regional Office
FY	fiscal year
GDP	gross domestic product
HIV	human immunodeficiency virus
IBP	International Budget Partnership
IFI	international financial institution
IFF	illicit financial flow
ILO	International Labour Organization
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
LIC	low income country
LMIC	lower middle income country
MoF	Ministry of Finance
MP	member of parliament
ODA	official development assistance
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PETS	Public Expenditure Tracking Survey
PFM	public financial management
PIT	personal income tax
PPP	purchasing power parity
SDG	Sustainable Development Goal
UMIC	upper middle income country
UNDESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNECA	United Nations Economic Commission for Africa
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNICEF	United Nations Children's Fund
US\$	United States dollar
VAT	value added tax
WASH	water, sanitation and hygiene
WHO	World Health Organization

List of tables and figures

Table 2.01.	The fiscal space accounting framework
Table 2.02.	Main fiscal space options assessed in the 16 country studies
Figure 2.01.	GDP projections and income classification, 2019 (in per capita and billions of current US\$)
Figure 2.02.	Nominal GDP growth, 2017-18 and 2019-20 period averages (as %)
Figure 2.03.	Real per capita GDP growth, 2017-18 and 2019-20 period averages (as %)
Figure 2.04.	Definitions of priority or human capital expenditure
Figure 2.05.	Budget classification systems used
Figure 2.06.	Government expenditure on education and health, 2017 or latest available (as % of total expenditure)
Figure 2.07.	Common expenditure challenges in human capital sectors (# of countries)
Figure 2.08.	Change in human capital investments after a five-year period based on the baseline scenarios (in per child constant US\$ and as %)
Figure 2.09.	Nominal and real per capita general government revenue, 2019-21 (as %, average of 16 countries)
Figure 2.10.	Nominal and real per capita general government revenue trends, 2019-21 period average projections (annual average percentage change)
Figure 2.11.	Tax revenue trends (as % of GDP)
Figure 2.12.	Potential additional impact of new tax revenue on human capital investments after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)
Figure 2.13.	Net ODA and official aid trends, 2000-21 (in billions and per capita constant 2015 US\$, total and average of 16 countries)
Figure 2.14.	Trends in net ODA and official aid per capita, 2016-18 and 2019-21 period averages (in constant 2015 US\$)

- Figure 2.15. Potential additional impact of increased ODA on human capital investments after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)
- Figure 2.16. The impact of reallocating 50% of military expenditure to education, 2017 (or latest available) (as % of total expenditure)
- Figure 2.17. The impact of reallocating 50% of military expenditure to health, 2017 (or latest available) (as % of total expenditure)
- Figure 2.18. Potential additional impact of budget reprioritization on human capital investments after a five-year projection period compared to the baseline scenario
- Figure 2.19. Education budget credibility rates, latest available 3-year period averages (actual expenditure as % of approved allocation)
- Figure 2.20. Health budget credibility rates, latest available 3-year period averages (actual expenditure as % of approved allocation)
- Figure 2.21. Crude estimates of “lost” education and health resources, latest available three-year period averages (in PPP, current international US\$)
- Figure 2.22. Potential additional impact of higher capital budget execution rates on actual human capital investment after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)
- Figure 2.23. General government net borrowing, 2016-18 and 2019-21 period averages (as % of GDP)
- Figure 2.24. General government gross debt, 2012, 2018 and 2019-21 period average (as % of GDP)
- Figure 2.25. Risk of debt distress, latest available
- Figure 2.26. Present value of external debt and debt distress, 2017 (as % of GDP)
- Figure 2.27. Present value of external debt and debt distress thresholds in the 16 fiscal space countries, 2017 (as % of exports of goods, services and primary income)
- Figure 2.28. Potential additional impact of borrowing to increase human capital investments after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)

Figure 2.29.	Trends in illicit financing flows, 2004-13 (in billions of current USD and as % of GDP, total and average of 16 countries)
Figure 2.30.	IFFs, 2011-13 period averages (in millions of current USD and as % of GDP)
Figure 2.31.	Potential additional impact of recapturing half of estimated IFFs on health expenditure (as % increase on health budget based on the application of different tax rates: 10%, 20% and 30%)
Figure 2.32.	Potential additional impact of five alternative scenarios to increase human capital investments after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)
Table 2.01.	Country profiles: Rapid assessment of fiscal space potential by select indicators, 2019-21 (or latest available) (in projected average annual changes or latest available levels – see Annex 3 for description of rating methodology)
Table 2.02.	Country profiles: Rapid assessment of fiscal space potential by categories over 2019-21 period (see Annex 3 for description of rating methodology)
Figure 3.01.	Open Budget Index scores in the 16 political economy countries, 2017
Figure 3.02.	Main advocacy entry points identified in the budget cycle in the 16 political economy countries (in # of countries)
Figure 3.03.	Main advocacy entry points identified in budget transparency and accountability processes in the 16 political economy countries (# of countries)
Annex 2, Table 1	Summary of main differences between the original and adjusted models in the baseline scenario
Annex 2, Table 2	Summary of main differences between the original and adjusted models in the alternative scenarios
Annex 3, Table 3	Indicators and thresholds to determine fiscal space potential

CHAPTER 1.

INTRODUCTION

The Eastern and Southern Africa region (ESAR) faces a series of daunting development challenges. Front and centre is child poverty. On average, nearly two in every three children in the region suffer from multiple dimensions of poverty. These range from lack of access to basic things like clean drinking water and safe places to wash and go to the toilet, and essential services like health and education, to suffering from hunger or emotional and physical violence.¹ The ongoing demographic boom is another pressing issue. Between 2019 and 2050, the 0-17 population in ESAR will nearly double – from around 250 million to 400 million.² In practical terms, service delivery systems, which already fall far short in terms of coverage and quality, are being under increasing stress from the growing demand. The region has also seen dramatic changes in the development financing landscape over the past decade, with official development assistance (ODA) declining considerably in most countries.³ This means that governments need to continuously scale up domestic investment in basic social services just to maintain a stable level of per capita expenditure each year. And if they are to have any realistic chance of benefiting from a demographic dividend, governments will need to significantly increase investment in human capital to address both current and future deficits.

UNICEF's Eastern and Southern Africa Regional Office (ESARO) initiated a multi-country initiative to better understand the dynamics of investing in human capital. The project had two main objectives. The first was to identify a set of feasible options available for governments to increase expenditure on the sectors that matter most for children and human capital development while maintaining fiscal sustainability (a fiscal space analysis). And the second was to pinpoint strategic entry points for UNICEF to more effectively engage in and influence government investment processes, given the prevailing political and economic context (a political economy analysis). While the fiscal space analysis was meant to open financing discussions with government counterparts and serve as a tool that can be updated and expanded, the political economy analysis aimed to inform UNICEF's internal strategies to more meaningfully engage in and influence public finance processes. The methodologies were field tested in Zambia at the end of 2016 and further refined in a first group of country studies in early 2017 (Burundi, Kenya, South Africa and the United Republic of Tanzania); the final group was completed in September 2018. In total, the complementary studies were carried out in 16 countries in ESAR.

Drawing on the findings from the 16 country studies, this report has two objectives. The first is to identify opportunities available to governments in ESAR to increase investment in human capital. Building on the World Bank's Human Capital Project, human capital investments are considered those that directly contribute to child survival, health and education – namely, the health, education, social protection, child protection, and water and sanitation sectors.⁴ The second objective is to highlight strategic entry points for UNICEF to more effectively influence national budget processes and close critical investment gaps. In the countries that participated in this initiative, it is hoped that the

¹ Based on the latest child poverty reports produced by UNICEF offices in ESAR, which are available at: https://www.unicef.org/esaro/resources_child-poverty-analysis.html.

² United Nations Department of Economic and Social Affairs (UN DESA) (2017). *UN DESA World Population Prospects: 2017 Revision (medium variant estimates)*.

³ United Nations Children's Fund (UNICEF) and International Budget Partnership (IBP) (2017). *Financing for Development: The state of budget transparency and investments in children in Africa*. Nairobi and Washington, DC: UNICEF ESARO and IBP.

⁴ World Bank (2018). *Human Capital Project*. Washington, DC.

evidence and strategies will continue to be updated and used by UNICEF and partners to influence public financial management (PFM) processes and decisions to enhance the investment outlook for children. Elsewhere, it is hoped that this approach can be adapted and used to advance the financing of human capital agendas.

The remainder of the report is structured as follows: Chapter 2 discusses the background and findings from the fiscal space analyses and Chapter 3 the political economy analyses; Chapter 4 then provides concluding thoughts, including a discussion of some of the key challenges around generating fiscal space and channelling additional resources to human capital sectors.

CHAPTER 2.

FISCAL SPACE FOR CHILDREN AND HUMAN CAPITAL IN EASTERN AND SOUTHERN AFRICA

This chapter presents the main findings from the fiscal space analyses that were carried out in 16 countries in ESAR. It starts by describing the process that was followed to develop each study at the country level, which is followed by a short overview of the economic situation across the countries to illustrate the vast differences in income, economic sizes and growth trends of the sample. Next, it discusses the definitions and trends in government expenditure on human capital, including a review of key challenges around planning, implementing and monitoring related budgets. The chapter then introduces the concept of fiscal space that was used to design the country-level approach. This is complemented by a regional assessment of the main components of fiscal space based on information and projections from global databases, which sets the stage for presenting the country-specific findings from the modelling exercises. To conclude, the chapter attempts to identify the most promising avenues for the region – and individual countries – to expand investment in human capital sectors.

2.1 Background to the country studies

The 16 fiscal space exercises started by identifying “priority” sectors for children and recent government investment trends in these areas. The priority sectors were defined following discussions with government counterparts. At a minimum, these covered education, health and social protection, which, when combined, form the foundation of human capital and children’s welfare in a country. These definitions were then used to analyse recent government investment trends, including the share of the total budget devoted to human capital areas as well as the level of those investments, in relation to both gross domestic product (GDP) and the size of the population.

Table 2.01. The fiscal space accounting framework

Total priority non-interest expenditure =
Tax and non-tax, non-interest revenue (excluding external grants)
+ External and internal interest receipts
+ External grants
Total non-priority, non-interest expenditure
+ External debt disbursements
External debt service (repayment and interest)
Internal Interest
+ Net internal financing flows (= fiscal gap)

With the historical analysis in hand, a fiscal space accounting framework was developed to assess how human capital investments could be increased going forward. Each exercise was based on a macro-fiscal programming model that projected the evolution of fiscal space according to different medium-term scenarios. Using a fiscal space accounting framework (Table 2.01), the model was constructed with national data on expenditure, revenue, borrowing, foreign aid, economic output and so on, as well as with projections for key economic, fiscal and demographic variables from global sources (mainly the International Monetary Fund or IMF and the United Nations). Afterwards, the base scenario was compared to alternative scenarios to identify potential opportunities to invest more in core human capital sectors.

The fiscal space accounting framework was established using a set of neutral, non-controversial assumptions. Based on historical data, the base scenario projected what would happen in a business-as-usual situation. In this way, the country studies attempted to address the question of whether the government possesses adequate capacity to fund human capital expenditure in the future, typically over a five-year projection period. The results from these baseline scenarios are presented for all countries in Section 2.4.

The analysis then looked at and evaluated options to increase the availability of fiscal space. The fiscal space accounting framework enabled looking at the consequences of sets of assumptions (“alternative scenarios”) that describe future macroeconomic conditions or policy choices. The approach for identifying and reviewing fiscal space scenarios is described below in Section 2.2. The final set of scenarios was selected on the basis of a literature review along with discussions with UNICEF staff and government counterparts. In each country report, a subset of options was presented as most likely or most feasible based on the results of the modelling exercises.

At the country level, the fiscal space work was carried out in three phases. The first phase consisted of data collection and a broad review of recent trends in overall and human capital expenditure. The second phase involved developing the macro-fiscal programming model to project the evolution of expenditure on human capital. This included preparing the base scenario and then comparing that to the alternative scenarios as agreed by different stakeholders. The final phase was the production of an analytical report to summarize the results.⁵ Annex 1 presents an abbreviated summary of how the fiscal space analysis was carried out at country level.

2.2 Framework for assessing fiscal space

The approach developed in this regional initiative built on prior efforts to describe and understand the concept of fiscal space. Perhaps the most widely-cited definition is from a 2005 IMF Policy Discussion Paper.⁶ This referred to fiscal space as the “availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government’s financial position.” In 2007, the United Nations Development Programme (UNDP) offered a slightly different perspective by contextualizing fiscal space within human development objectives and presenting a simple assessment framework. Known as the “fiscal space diamond,” this consisted of four channels to generate resources: (i) ODA; (ii) domestic revenue mobilization; (iii) deficit financing; and (iv) reprioritization and efficiency of expenditures.⁷

⁵ The final reports are available here: https://www.unicef.org/esaro/resources_fiscal-space-analysis.html.

⁶ Heller, P. (2005). *Understanding Fiscal Space*. IMF Policy Discussion Paper, PDP/05/4, page 3.

⁷ R Roy, R., Heuty, A. and Letouzé, E. (2007). *Fiscal Space for What? Analytical Issues from a Human Development Perspective*. G-20 Workshop on Fiscal Policy. Istanbul, Turkey, 30 June to 2 July 2007. New York City: UNDP, page 6.

In 2011, UNICEF put forth a more comprehensive approach by unpacking and expanding the fiscal space diamond.⁸ This included several important differences, which are discussed below.

First, it presented “reprioritization” and “efficiency of expenditures” as separate pathways to create fiscal space. This was a pragmatic consideration as one is about the design of the national budget (i.e. the overall composition by sectors or ministries) and the other is about how budgets are implemented at the sector or ministry level. As such, the underlying issues and processes for getting more out of available resources are very different.

Second, it disaggregated the ODA and deficit financing corners of the diamond, recognizing the changing landscapes and complexities of these pathways. On the ODA front, this included emphasizing the emergence of influential south-based providers, such as from China, India and the Middle East, foundations and new global funds, as well as the implementation of new aid modalities (combining market-based lending instruments with concessionary features or grants, budget support programmes, etc.). On the debt front, the scope was expanded beyond borrowing, acknowledging that fiscal space can also be created by re-structuring existing debt obligations and/or repayment terms, which had been successfully executed by many governments.

Third, UNICEF’s approach identified several additional channels that can create fiscal space. These included: (i) adopting novel fiscal and monetary policies to boost expenditure, some of which were used by governments to respond to the global financial crisis (e.g. quantitative easing, printing money); (ii) using fiscal savings, such as those stored in sovereign wealth funds, which many governments have at their disposal; (iii) deploying foreign exchange reserves to support public-private partnerships and investment in development projects; and (iv) preventing and capturing illicit financial flows, which are one of the largest potential untapped sources of development financing. In 2017, the International Labour Organization (ILO), UNICEF and UN Women jointly published a new paper to contextualize this expanded approach to finance the Sustainable Development Goals (SDGs), which further identified social security contributions as another funding source available to more advanced economies.⁹

ESARO’s regional initiative adapted the comprehensive approach to fiscal space that was most recently endorsed by various United Nations agencies. A summary of the broad areas that were reviewed in the 16 country studies is presented in Table 2.02 below. These included: (i) increasing government revenue; (ii) increasing ODA; (iii) reprioritizing spending; (iv) improving the efficiency of spending; (v) borrowing; (vi) restructuring debt; (vii) using fiscal savings; and (viii) capturing and/or preventing illicit financial flows. Additional options were not explored in the country studies due to the limited potential to create resources for human capital expenditure given the characteristics of ESAR. These included certain types of non-tax revenue (from the sale or rents of state-owned enterprises or assets, increasing fees for permits or licenses, increasing fines/penalties, etc.), increasing social security contributory revenue from employers and/or employees, investing foreign exchange reserves, and printing money.

8 Ortiz, I., Chai, J. and Cummins, M. (2011). *Identifying Fiscal Space: Options for Social and Economic Development for Children and Poor Households in 184 Countries*. UNICEF Social and Economic Policy Working Paper.

9 Ortiz, I., Cummins, M. and Karunanethy, K. (2017). *Fiscal Space for Social Protection and the SDGs: Options to Expand Social Investments in 187 Countries*. ILO Extension of Social Security (ESS) Working Paper No. 48. Geneva: ILO, UNICEF and UN Women.

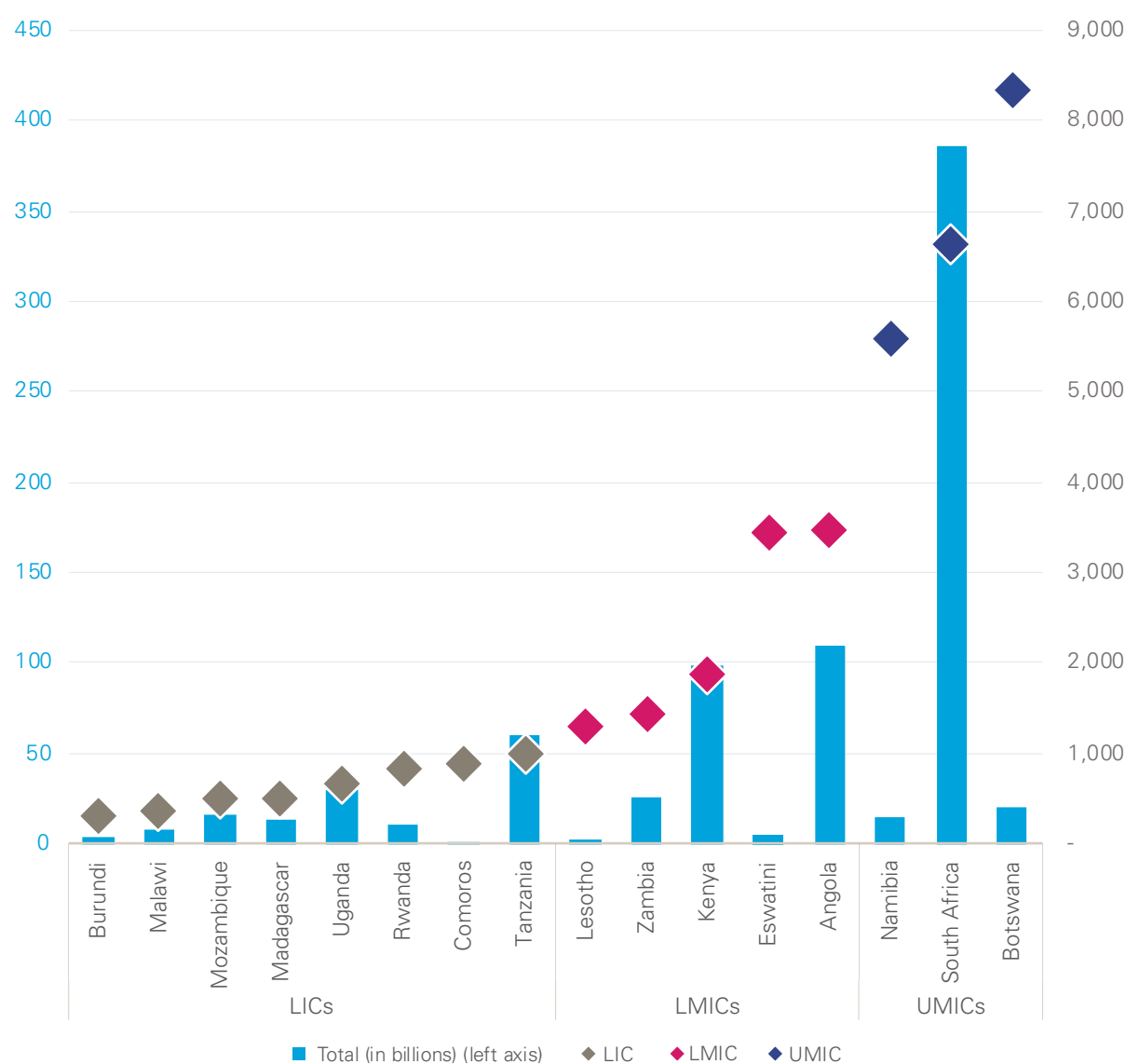
Table 2.02. Main fiscal space options assessed in the 16 country studies

Options	Parameters
1. Increasing government revenue	<ul style="list-style-type: none"> Increasing revenue based on natural economic growth Introducing new taxes or increasing tax rates e.g.: <ul style="list-style-type: none"> ➤ VAT and other consumption/sales taxes, especially on luxury goods ➤ Income taxes (personal and corporate) ➤ Local government taxes (e.g. property, parking) ➤ Sin taxes (e.g. alcohol, tobacco, sugar products) ➤ Carbon taxes (e.g. on polluting industries or products) ➤ Natural resource extraction taxes (e.g. on minerals, oil, gas) ➤ Financial sector taxes (e.g. on currency or equity transactions, capital controls) ➤ Tourism taxes (e.g. on hotel rooms, airline tickets, tourist activities) ➤ Tariffs (on imports and/or exports) ➤ User fees (e.g. for roads, bridges, ports, airports) ➤ Reducing tax exemptions (e.g. on the parastatal sector, imports, capital gains, tax holidays) Improving revenue collection capacity (e.g. by strengthening the national revenue authority's human resources, technologies, systems, etc. to enforce existing tax policies and minimize tax evasion)
2. Increasing ODA	<ul style="list-style-type: none"> Increasing grants and concessional financing from: <ul style="list-style-type: none"> ➤ Multilateral donors: African Development Bank, World Bank, IMF, Islamic Development Bank, United Nations etc. ➤ Bilateral donors: International Development Cooperation Agency (China), EuropeAid Development and Cooperation (European Union), French Development Agency, Deutsche Gesellschaft für Internationale Zusammenarbeit, Japan International Cooperation Agency, Saudi Fund for Development, Turkish Cooperation and Coordination Agency, United Kingdom Department for International Development, United States Agency for International Development etc. ➤ Global funds: Global Fund to Fight AIDS, Tuberculosis and Malaria; Gavi, the Vaccine Alliance; Global Education Fund, etc. ➤ Foundations: Bill & Melinda Gates Foundation, Open Society Foundations, Ford Foundation, William and Flora Hewlett Foundation, etc.
3. Reprioritizing spending	<ul style="list-style-type: none"> Reallocating resources away from non-priority sectors (e.g. defence/security) or from spending items that distort the economy (e.g. state-owned enterprises) or generate social inequalities (e.g. fuel subsidies)
4. Improving the efficiency of spending	<ul style="list-style-type: none"> Improving the efficiency of resources that are allocated to sectors that support human capital e.g. by fully spending available resources, minimizing leakages, improving procurement processes to get more and better goods/services at lower costs
5. Borrowing	<ul style="list-style-type: none"> Accessing concessional financing, e.g. from the African Development Bank or World Bank Issuing bonds on domestic or international markets Borrowing from domestic or international financial institutions
6. Restructuring debt	<ul style="list-style-type: none"> Refinancing or negotiating a lower interest rate and/or later maturity date to reduce current payments on domestic and/or external debt obligations
7. Using fiscal savings	<ul style="list-style-type: none"> Investing resources stored in sovereign wealth funds (most commonly from natural resource income streams) or alternatively accrued through budget surpluses, profits of state-owned enterprises, privatization receipts or other government net income
8. Capturing and/or preventing illicit financial flows	<p>Some examples include:</p> <ul style="list-style-type: none"> ➤ Detecting and deterring cross-border tax evasion ➤ Eliminating anonymous shell companies ➤ Curtailing trade mis-invoices ➤ Strengthening and enforcing anti-money laundering laws and practices ➤ Improving the transparency of multinational corporations

2.3 The economic context

Fiscal space analyses were carried out in a mix of low-income and middle-income countries in ESAR and across very different types of economic situations. Under the World Bank's income classification system, the sample contained an equal balance of eight middle-income countries – five lower-middle income countries (LMICs) and three upper-middle income countries (UMICs) – and eight low income countries (LICs) (Figure 2.01). On one side of the spectrum, this included some of the world's poorest countries, like Burundi, Madagascar and Malawi, while on the other side, it contained UMICs with relatively high living standards (e.g. Botswana, Namibia, South Africa). At the same time, the sample contained a range of economic sizes, from Comoros, with GDP projected to be around US\$750 million in 2019, to South Africa – near US\$400 billion.

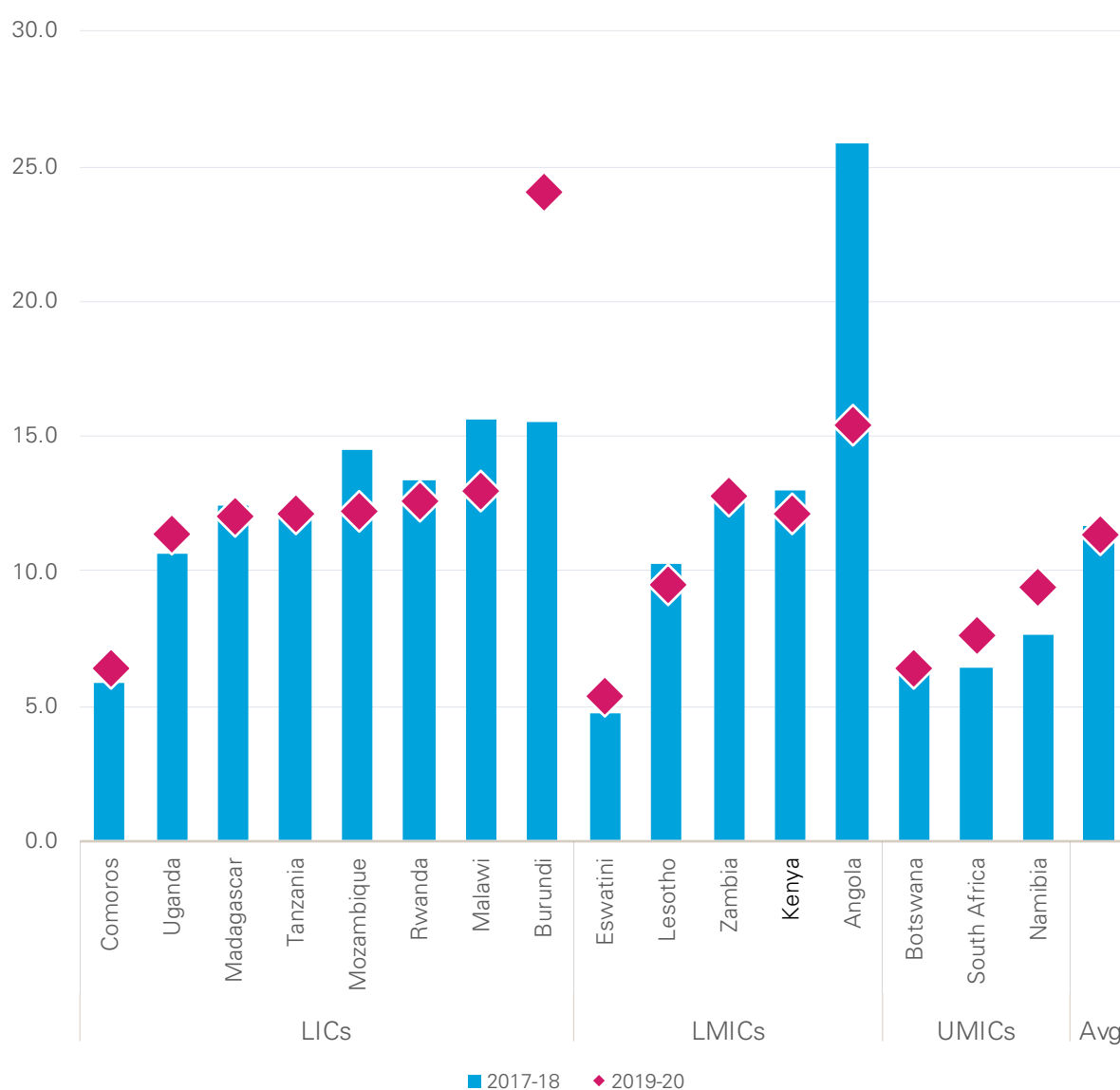
Figure 2.01. GDP projections and income classification, 2019 (in per capita and billions of current US\$)



Sources: IMF World Economic Outlook Database (October 2018) for data on GDP and World Bank Country and Lending Groups, Fiscal Year 2018-19 for income classifications.

Recent economic growth performance and short-term projections are equally diverse across the sample. In nominal terms, the average growth over the 2017-18 period was 11.7 per cent for the 16 countries. This was projected to slightly slow down to an average of 11.4 per cent over the 2019-20 period (Figure 2.02). While the short-term trajectories for most countries follow the regional trend of sustained but not increasing growth, there are several outliers. On the negative front, Angola's economy is expected to slow down by more than ten percentage points, from 26 to 15 per cent between the 2017-18 and 2019-20 periods. Burundi's economic growth, in contrast, is forecast to continue to rapidly accelerate, from 15 to 24 per cent over the same period. All other countries are expected to broadly maintain their recent economic growth levels over the near term within a range of plus or minus two per cent.

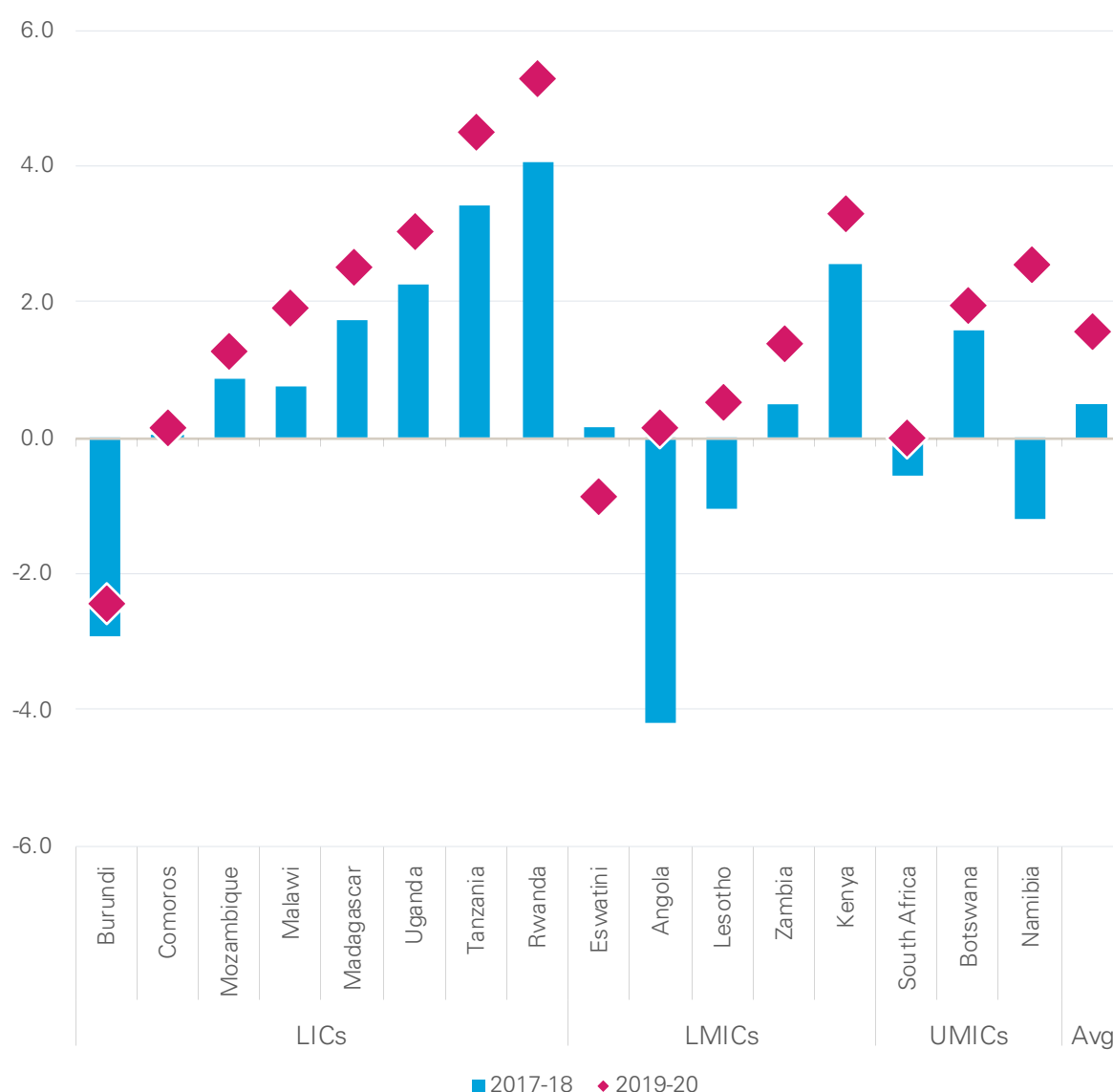
Figure 2.02. Nominal GDP growth, 2017-18 and 2019-20 period averages (as %)



Source: Author's calculations based on IMF World Economic Outlook Database (October 2018).

However, once factoring in demographic and price changes, the economic growth picture becomes much less impressive across the sample. For instance, the rosy outlooks for some countries are upended after adjusting economic output projections by the size of the population and the inflation index (Figure 2.03). In Burundi, the growth outlook for 2019-20 tumbles from a robust 24 per cent in nominal terms to negative growth in real per capita terms (-2 per cent); in Angola, growth falls from 15 per cent to virtually no growth (0.1 per cent) with the same considerations. When looking at the entire sample, 13 countries are projected to grow by an average of 2.2 per cent in 2019-20 in real per capita terms, while three are countries projected to contract on a real per capita basis (Burundi, Eswatini and South Africa).

Figure 2.03. Real per capita GDP growth, 2017-18 and 2019-20 period averages (as %)



Sources: IMF World Economic Outlook Database (October 2018) for data on GDP and World Bank Country and Lending Groups, Fiscal Year 2018-19 for income classifications.

2.4 Expenditure on human capital

2.4.1. Definitions and budget classification issues

Each country developed its own definition of “priority” or human capital expenditure. In practice, a series of discussions were held with government counterparts and other stakeholders to identify a set of expenditure lines considered directly beneficial to children and foundational to human capital. Naturally, this is an arbitrary exercise that creates a unique definition of priority expenditure, based on both the choice of “human capital-friendly” sectors and the budget classification systems that are in place. In general, education, health and social protection¹⁰ were considered priority expenditure in all countries¹¹ (Figure 2.04). In addition, water, sanitation and hygiene (WASH) spending was considered priority expenditure in six countries, nutrition in two countries and child protection in two countries.

The definitions of priority expenditure were also affected by the availability and organization of budget information. Most of the studies (11) relied on the administrative classification of the budget, whereby spending is aligned to government structures (Figure 2.05). The other studies were based on the functional classification, with budget information organized according to spending objectives. Most of the countries that used the functional classification defined priority expenditure beyond education, health and social protection. This is unsurprising since information under this classification system tends to make it easier to identify spending that cuts across administrative boundaries, as is the case in child protection, nutrition and WASH. However, this was not universal.

2.4.2. Human capital expenditure trends

Before discussing country-level trends according to national definitions, it can be helpful to offer a regional perspective of investment in human capital based on comparable information. This type of analysis is inherently challenging due to the use of different definitions and budget classification systems across countries, but a preliminary picture can be obtained by drawing on global efforts to standardize boundaries for core human capital sectors – mainly national education accounts and national health accounts (compiled by the United Nations Educational, Scientific and Cultural Organization or UNESCO and the World Health Organization or WHO respectively). Based on the latest available estimates, only 3/16 countries (Botswana, Eswatini and Lesotho) spent at least 20 per cent of their national budgets on education, thereby meeting their financial commitment to the Incheon Declaration and SDG 4 to “ensure inclusive and equitable quality education and promote lifelong learning opportunities for all”¹² (Figure 2.06: blue bars). Performance on the health front is equally discouraging, as just 2/16 countries (Eswatini and Malawi) recently devoted at least 15 per cent of their national budget to health in line with the Abuja Declaration spending target (Figure 2.06: red bars).¹³ Here, the main takeaway is that the budget priority given to core human capital sectors varies widely across the sample but almost always falls below international targets.

Turning to country-level information, expenditure on nationally-defined human capital sectors rose over the historical period reviewed in only five countries. In Zambia,

¹⁰ Note: Social protection is used as a categorial term, but the sector definition varies by country (e.g. social development, social welfare).

¹¹ Comoros was the only exception, where education and health were defined as priority expenditure.

¹² United Nations Educational, Scientific and Cultural Organization (UNESCO) (2015). *Incheon Declaration and SDG4 – Education 2030 Framework for Action*. Paris: UNESCO, page 9.

¹³ World Health Organization (WHO) (2011). *The Abuja Declaration: Ten Years On*.

Figure 2.04. Definitions of priority or human capital expenditure

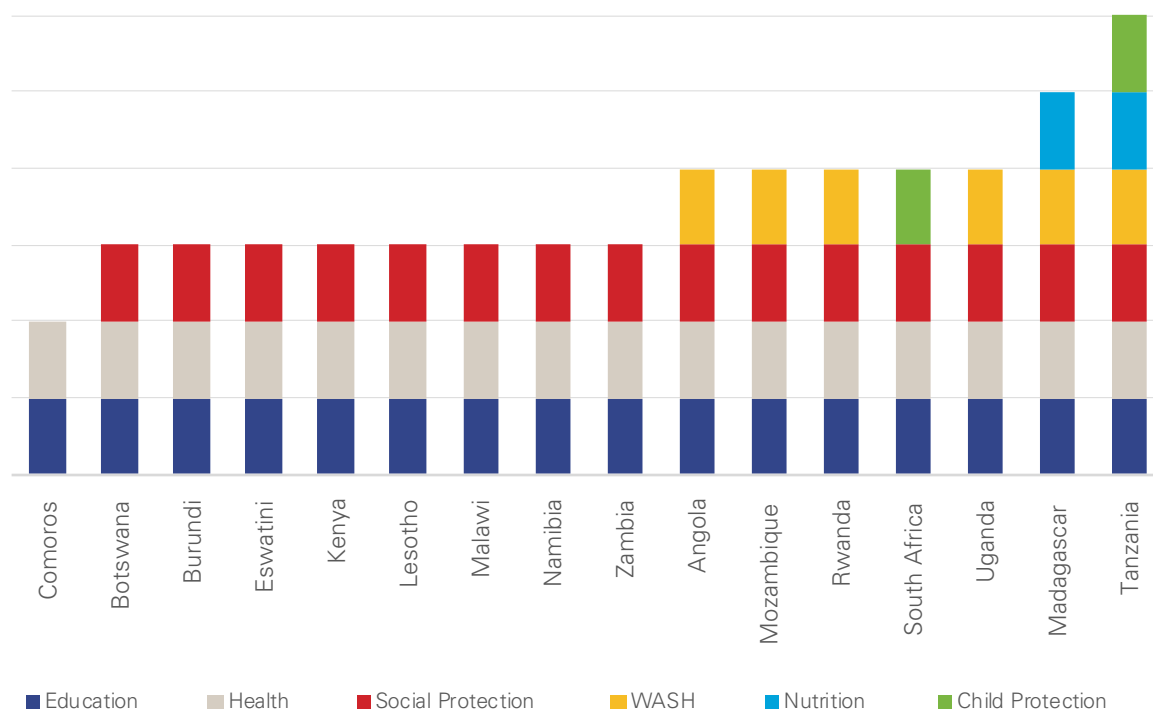


Figure 2.05. Budget classification systems used

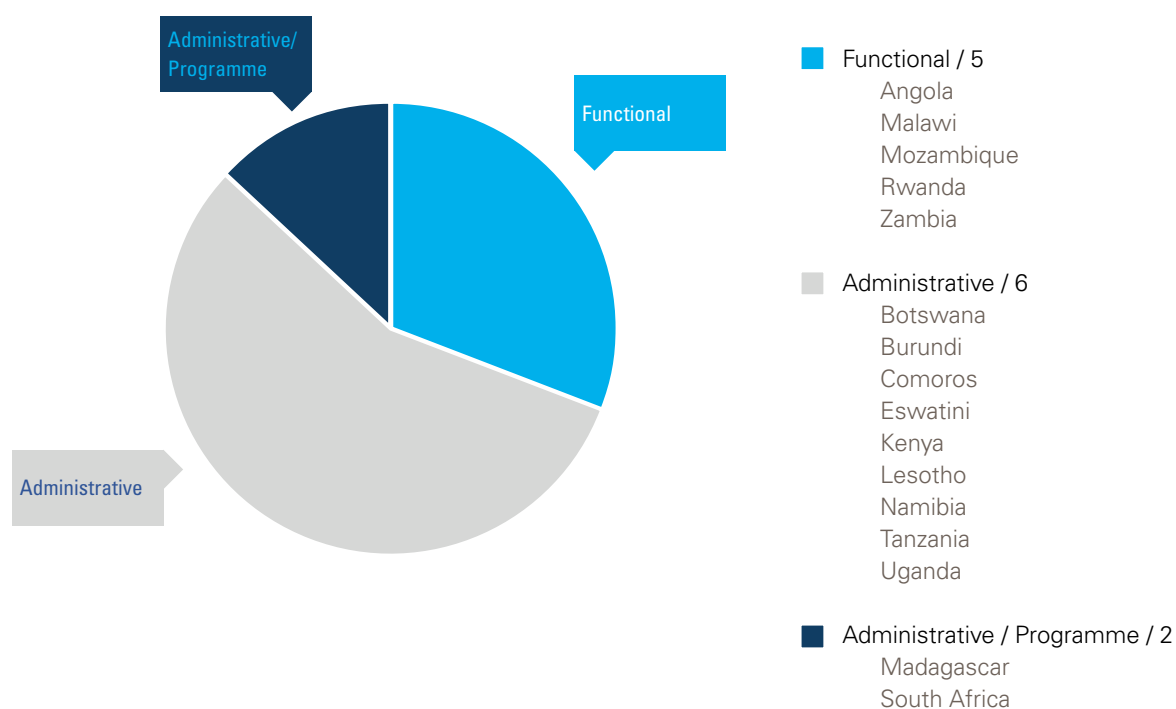
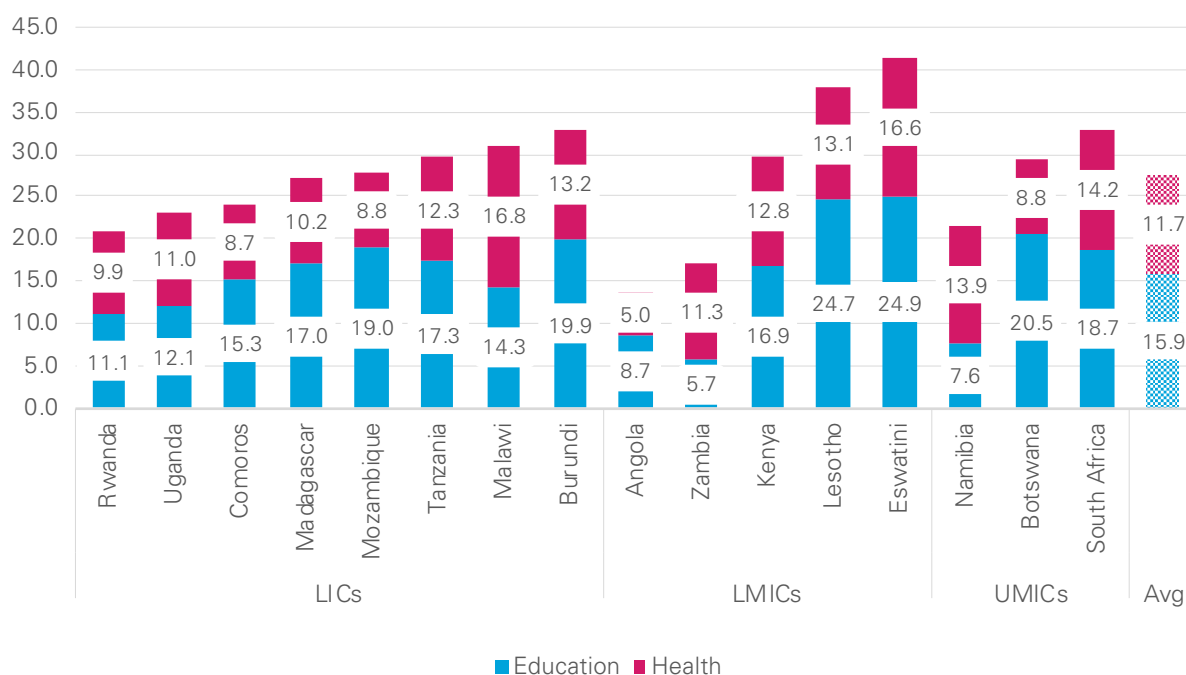


Figure 2.06. Government expenditure on education and health, 2017 or latest available (as % of total expenditure)



Sources: WHO Global Health Expenditure Database for data on health and UNESCO Institute for Statistics for data on education.

expenditure increased both as a percentage of GDP and in per child terms. In South Africa, even though the economy grew very modestly in recent years, education and health expenditure were relatively protected, with expenditure on human capital increasing in terms of GDP. In Lesotho, in line with the government's commitment to improving education, health and social development, human capital expenditure similarly rose despite economic headwinds. Similarly, in Eswatini, driven by broader expansionary fiscal policy, expenditure on education and health consistently increased since FY2011/12. And in Madagascar, government expenditure on human capital sectors increased since FY2013, albeit minimally.

In six countries, expenditure on core human capital sectors was kept at a stable level over the period examined. In Kenya and the United Republic of Tanzania, human capital expenditure remained relatively steady in terms of GDP, with per child expenditure showing a small increase. In Botswana, human capital expenditure was roughly constant between FY2011 and FY2017 in terms of GDP and on a per child basis, but also emerged as one of the highest levels among the sample (around 11 per cent of GDP, on average). Namibia recorded an even higher commitment, with human capital expenditure fluctuating around 12 per cent of GDP. In contrast, Uganda's expenditure on human capital was relatively steady at 3.6 per cent of GDP, which was among the lower levels in the sample. And in Malawi, off-donor budget support complemented government expenditure, allowing expenditure on human capital to hover around 8 per cent of GDP.

Four countries experienced declines in human capital expenditure during the historical period, which was largely due to political and economic shocks. Burundi was characterized by low levels of expenditure, especially on social protection, which decreased in real terms between 2013 and 2015 and is among the lowest in Africa. This trend reflects not only the extraordinary depth of impoverishment in the country, but years of internal conflict that

prevented successive governments from effectively providing for the basic needs of the population. Angola was also marked by a big drop in human capital expenditure between 2013 and 2017, which fell more than 66 per cent in real terms. Much of this was a result of the fall in oil prices and the negative impact on revenue, with social protection bearing the brunt of the cuts (expenditure declined from 19 per cent of total expenditure in 2013 to 10 per cent in 2017). In the case of Mozambique, expenditure on human capital slightly contracted from around 12 to 11 per cent of GDP between 2015 and 2017 but declined nearly 20 per cent in real terms. This was due to both negative economic growth and escalating debt service payments, which consumed more than 20 per cent of total expenditure. And in Comoros, expenditure on human capital fell between 2014 and 2016, both as a percentage of total expenditure (from 30 per cent to 25 per cent) and in real per child terms (by close to 20 per cent).

Lastly, one country – Rwanda – was marked by wide expenditure fluctuations over the historical period. Here, the priority given to core human capital sectors declined from 25.2 to 23.7 per cent of total expenditure between FY2011-12 and FY2012-13. The trend then steadily reversed, with expenditure reaching 26.8 per cent of total expenditure on FY2015-16 before falling in FY2016-17 to 24.5 per cent. Similar movements were also observed when looking at human capital expenditure as a percentage of GDP, which could partially be explained by the strong focus on economic growth and investment in productive sectors.

2.4.3. Human capital expenditure challenges

Considering the generally poor state of social indicators and the ambitions expressed in national development plans, most countries spend inadequately on human capital. Among the main sectors examined, education accounts for the largest share of government investment, with health and especially social protection receiving significantly less funding. One common issue is that sector strategies and action plans are designed on the assumption that a certain level of allocations will be received, while actual funding commitments fall short of expectations. In the United Republic of Tanzania, for example, despite the existence of costed multi-sector national action plans and government funding pledges, very large gaps are observed in the budgets for health and social protection. Or in Uganda, the National Development Plan emphasizes human capital development as one of its priorities, but this is not sufficiently reflected in budget allocations.

To realize ambitious development plans and to cope with the growing demand for services due to demographic forces, there is a clear need for more investment in human capital sectors. As described in the previous section, most of the countries studied did not experience a steady increase in human capital expenditure, especially in real per capita terms. Recent investment trends therefore indicate that the rapid and large scaling up of basic programmes to develop human capital, especially health and social protection, will not be realized in most countries anytime soon. For instance, the introduction of a single-payer health care system in South Africa requires a substantial increase of resources for the health sector, while expanding the coverage and/or benefits of social assistance programmes – which are already among the largest in the world – will equally require massive amounts of fiscal space. Or in Uganda, a recent social protection investment case identified severe financial gaps when comparing recent investment trends with cost estimates for progressively expanding different schemes.¹⁴

Beyond the obvious funding shortages, the country studies also shed light on some of the key challenges related to spending resources that have been released to human

¹⁴ UNICEF Uganda (2017). *Social Protection Investment Case*.

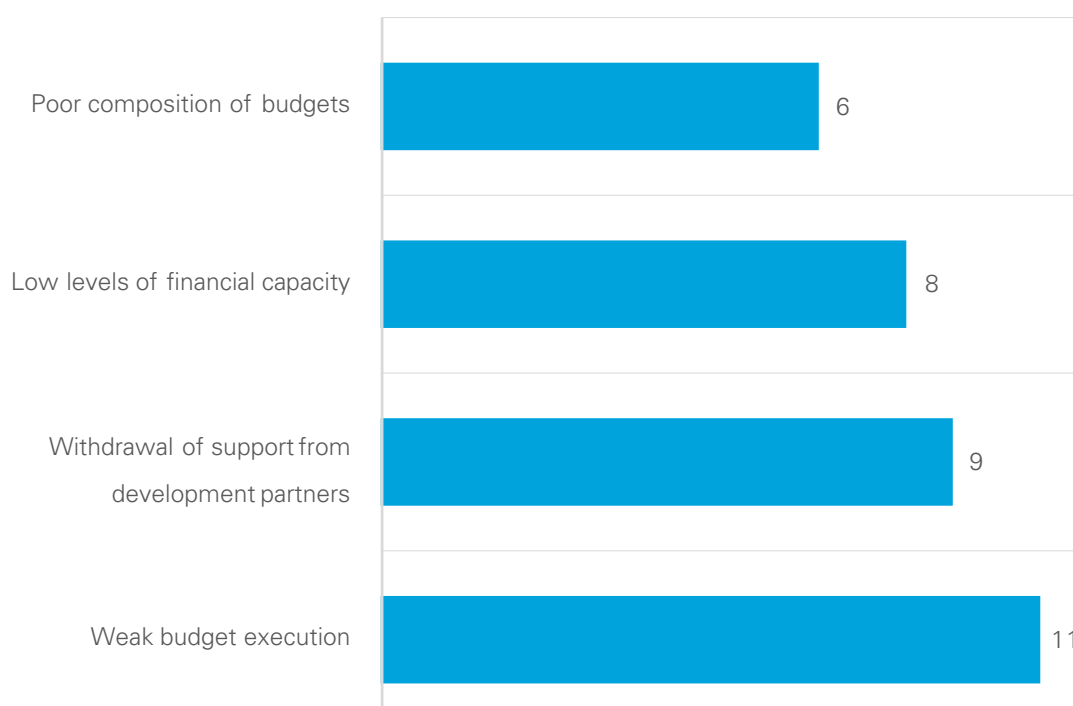
capital sectors. Although a variety of issues were documented in the country studies, this section focuses on the four most prevalent (Figure 2.07). Budget execution emerged as the foremost challenge, severely affecting at least 11/16 countries examined. The withdrawal of donor support, low financial capacity and the poor design of human capital budgets are other recurring challenges, each of which was identified in roughly half of the studies. These issues are discussed below.

Weak budget execution was identified as the primary expenditure challenge in human capital sectors, which affected nearly all countries studied. The country studies confirmed well-documented findings from the broader literature on PFM¹⁵ that the primary budget execution bottlenecks are in capital (or development) budgets. This was also found to apply equally to both domestic and external funding sources. This makes sense intuitively given that expenditure on recurrent items, like salaries, tends to be straightforward and is often automated. When looking at capital budgets, however, many of the spending challenges are associated with the ongoing move toward decentralization. Specifically, where service delivery has been delegated to lower administrative levels, there is often insufficient human capacity to plan and manage resources; weak controls and information systems present additional bottlenecks. Procurement can also be problematic, with cumbersome processes and a limited supply of qualified service providers making contracting difficult in many places.

Another frequent spending challenge was linked to the withdrawal of donor support. In most of the countries studied, development partners (DPs) contribute a large share

15 Cangiano, M., Curristine, T. and Lazare, M. (2013). *PFM and Its Emerging Architecture*. Washington, DC: IMF.

Figure 2.07. Common expenditure challenges in human capital sectors (# of countries)



of capital expenditure on human capital sectors, especially in capital-intense sectors like WASH. This high level of support can lead to an overdependence on donors, which pushes the government to withdraw from certain sectors. DPs in Malawi, for example, have played an important role in financing human capital sectors, but this has affected the government's priority setting i.e. raising the share of the national budget for health is not urgent as long as donors are footing most of the bill. This may even be more acute in Comoros, where service delivery in human capital sectors is almost fully financed by donors, apart from salaries. At the same time, where donor support is provided off-budget, budget planning processes can be undermined while also running a high risk of services being duplicated and hence causing wastage.

Although partially captured above, low financial capacity was also commonly noted as a spending bottleneck. Perhaps this is most evident in decentralized spending units, which usually receive funding based on a nationally-defined allocation formula. Insufficient strength of local governments to stand up to decreasing transfers as well as continued concerns about PFM capacity make them easy targets for cutting or at least not increasing human capital budgets.

Another overarching challenge was allocative inefficiencies within human capital budgets. Not all countries spend their available resources in a manner that supports human capital or equity. For example, many governments devote a large share of their education and health budgets to tertiary services (e.g. universities or hospitals in urban locations), which have limited benefits for the most vulnerable populations. Botswana is a case in point, where, despite high and increasing human capital expenditure in recent years, over-investment in expensive tertiary education and curative healthcare services comes at the expense of under-investment in primary services. Similarly, social protection budgets are often consumed by subsidies that do not directly benefit the neediest populations, such as agricultural subsidies in Malawi or fuel subsidies in Angola, Mozambique, the United Republic of Tanzania or Zambia. The geographical equity of spending is another concern, as rural areas frequently receive far fewer resources on a per capita basis.

One intra-sectoral allocation constraint is the absence of costed sector plans. This leads to inadequate prioritization and unrealistic financial planning in budget preparation, as line ministries sometimes have inadequate insight into the costs of the policies they are supposed to implement. The appearance of unexpected costs can also lead to ad hoc budget execution and inefficient spending patterns. Lastly, this affects sector outcomes as financially pressured sectors tend to budget inadequately for maintenance costs, most notably in the WASH sector.

Improved financial planning would further facilitate a better balance between recurrent and capital expenditure and deliver better value for money. In some countries, spending on wages crowds out needed investment in capital items. In Madagascar, for example, where the quality of education is low and investment in education is essential, salaries consume around 90 per cent of the budget; a similar situation is observed in Comoros.

Beyond the design of budgets, inefficient human resource management also contributes to substantial wastage and poor outcomes in human capital sectors. For example, in South Africa specific areas of mismanagement relate to provinces employing more teachers than they can afford, the hiring of unqualified teachers and placing teachers in schools where they are not needed at the expense of schools where there are shortages.

2.5 The outlook for human capital expenditure

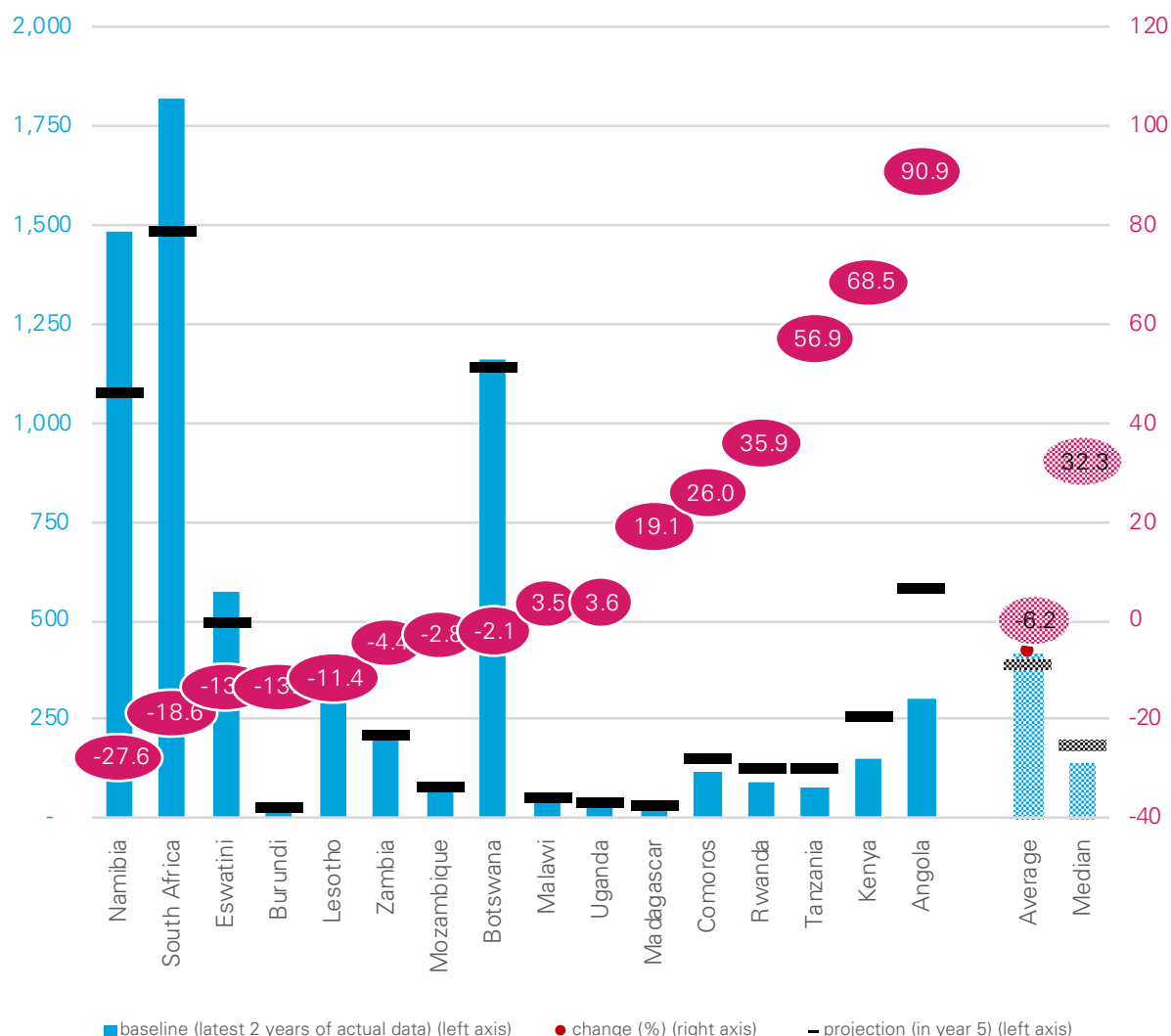
Before discussing different fiscal space options, it is first important to understand how investment in human capital may evolve if following a business-as-usual pathway. In each macro-fiscal programming model, a projection analysis was first carried out using a non-controversial set of assumptions to assess the likely growth of human capital investments over the future periods studied.

Although each model was unique, it was possible to standardize some of the features to allow for cross-country analysis of the human capital expenditure projections. This required introducing various configurations into each model, including re-defining human capital expenditure (education, health, social protection) and the age range of the child population (under 18), as well as re-setting the base values (average of latest two years of actual information) and end values (projection year 5). After the standardization process, the baseline and endline values for per child expenditure on human capital sectors were recalculated, still reflecting the original assumptions built into each model. A full description of the steps performed, as well as a summary of the differences between the original and adjusted models, is provided in Annex 2. Despite these changes, there are still notable issues that limit the accuracy of cross-country comparisons. These include different projection years, different base years for CPI and exchange rate conversions, and different definitions of human capital expenditure. Caveats aside, this approach does allow for a very broad picture of how expenditure on core human capital sectors could potentially evolve in the 16 countries, all other things equal.

When reviewing the expenditure projections across the 16 countries, the regional outlook for human capital investments is mixed. Based on the modified macro-fiscal programming models, the level of investment in human capital on a per child basis is projected to decline from US\$412 (in constant US\$ using country-specific base years) to US\$386, on average, when comparing the baseline values with the predicted values five years into the future (Figure 2.08). This amounts to a real decline in per child expenditure of approximately 6 per cent as a sample average. The picture does become more optimistic if looking at the median value of the sample, which captures the performance of the 50th percentile. Under this measure, real per child expenditure is projected to rise from US\$137 to US\$181 over a five-year horizon, on average, which amounts to a real increase of more than 30 per cent.

As indicated by the differences between the average and median values in the sample, there are significant variations across countries. Eight countries are projected to experience a decline in real per child expenditure on human capital sectors after a five-year period. This includes Botswana, Mozambique and Zambia, which are projected to experience a minimal decline at around 3 per cent on average, along with Burundi, Eswatini, Lesotho, Mozambique, Namibia, South Africa and Zambia, where per child expenditure is predicted to fall by an average of 17 per cent. Much of this can be attributed to the sluggish or negative economic growth outlooks, which are expected to limit government revenue and hence investment capacity. While Malawi and Uganda are projected to experience a minimal increase in real per child expenditure over a five-year horizon (both at 2 per cent), the other six countries show strong potential. Per child expenditure on human capital could increase by 20 per cent or more in real terms in Comoros and Madagascar, by more than 30 per cent in Rwanda, 50 per cent in the United Republic of Tanzania, close to 70 per cent in Kenya and 90 per cent in Angola. In the latter case, the eye-popping potential is not the result of an economic growth spurt far beyond what was projected in Section 2.3, but rather the government's recent commitment to aggressively increase the budget priority given to the education and health sectors in line with international spending targets by 2022.

Figure 2.08. Change in human capital investments after a five-year period based on the baseline scenarios (in per child constant US\$ and as %)



Source: Author's calculations based on modifications to country macro-fiscal programming models (see Annex 2).

Notes: Human capital investments are defined as those in education, health and social protection; the child population is all persons aged 0-17; the base year for constant US\$ and exchange rates varies across the sample.

The information on human capital expenditure projections presented above is critical for understanding the following the discussions. The results of different alternative scenarios will be weighed against their ability to improve on the results from the baseline scenarios.

2.6 Options to expand fiscal space in 16 ESAR countries

This section discusses the main options for maximizing fiscal space to facilitate greater investment in core human capital sectors. Based on information and projections from global databases, it first provides a regional picture of each option to highlight overall trends and possible opportunities. This is then complemented by the quantitative findings from the macro-fiscal programming models from the 16 countries.

To allow for a reasonable comparison of results across countries, the alternative scenarios developed in each model had to be adjusted. One of the main issues was that the additional fiscal space generated by the alternative scenarios in the country models was not exclusively used to increase human capital expenditure. On the contrary, it was often directed to debt repayment or to greater expenditure on other areas, whereby only a portion – or sometimes nothing at all – would benefit human capital expenditure. The models were therefore adjusted so that it was possible to isolate the full impact of an alternative scenario on human capital expenditure.¹⁶ As a result, the findings in this report may differ from those presented in the country reports. A complete description of the methodology used to adjust the alternative scenario results from the country models is provided in Annex 2.

2.6.1. Increasing government revenue

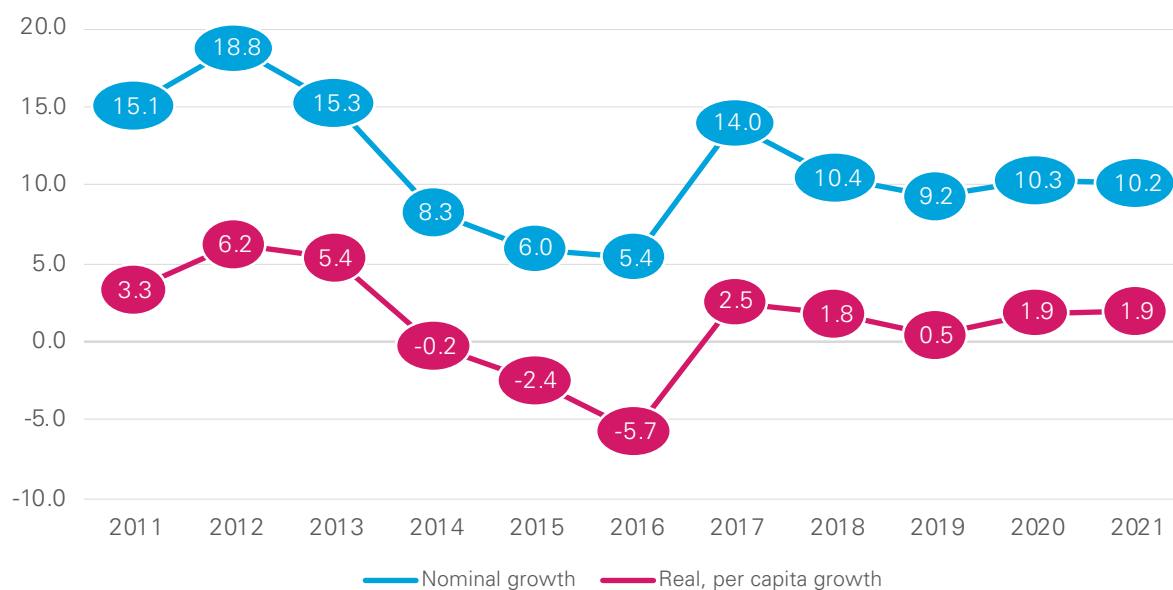
Natural revenue growth is the easiest way to progressively increase expenditure on core human capital sectors over time. When looking at the average values across the countries studied, general government revenue projections from the IMF indicate that revenue growth will slow from a recent peak of 14 per cent in 2017 to around 10 per cent over the 2019-21 period (Figure 2.09). As presented in Section 2.3, this reflects the strong economic growth outlooks over the near term in most countries. However, once factoring in price and demographic changes, the outlook is much more modest, with real per capita revenue growth expected to average only about 1.4 per cent per year between 2019 and 2021.

IMF projections indicate that all countries are likely to benefit from greater revenue flows to support human capital sectors, but the impacts of larger budgets will be muted due to rising prices and larger populations. If all other things are held constant, including the sectoral composition of budgets and spending performance, available funding for human capital sectors would be expected to increase by an average of about 10 per cent annually over the near term across the 16 countries. But taking an additional step to look at the impact, bigger budgets will only minimally increase the amount of goods and services that can be delivered at higher costs to larger populations. Over the 2019-21 period, the difference between the average annual growth of nominal and real per capita revenue is more than 8 per cent, on average (10.2 versus 1.9 per cent respectively).

Significant differences in total revenue growth potential are observed across the countries. Among the poorer performers, Botswana, Comoros and Eswatini are projected to experience 5-7 per cent growth in nominal terms during the 2019-21 period (Figure 2.10). In contrast, nominal revenue in Angola, Malawi, Uganda and the United Republic of Tanzania is projected to increase by 13 per cent or more each year over the same period. But just as in the regional analysis, growth becomes much lower – or even negative – for most countries once accounting for changing price levels and population sizes. Under the real per capita lens, four countries (Burundi, Eswatini, Mozambique and Zambia) are projected to experience negative growth, meaning that, if all other things are held constant, they will be able to provide fewer goods and services that foster human capital. On the other hand, Uganda and the United Republic of Tanzania will still be able to deliver much more with

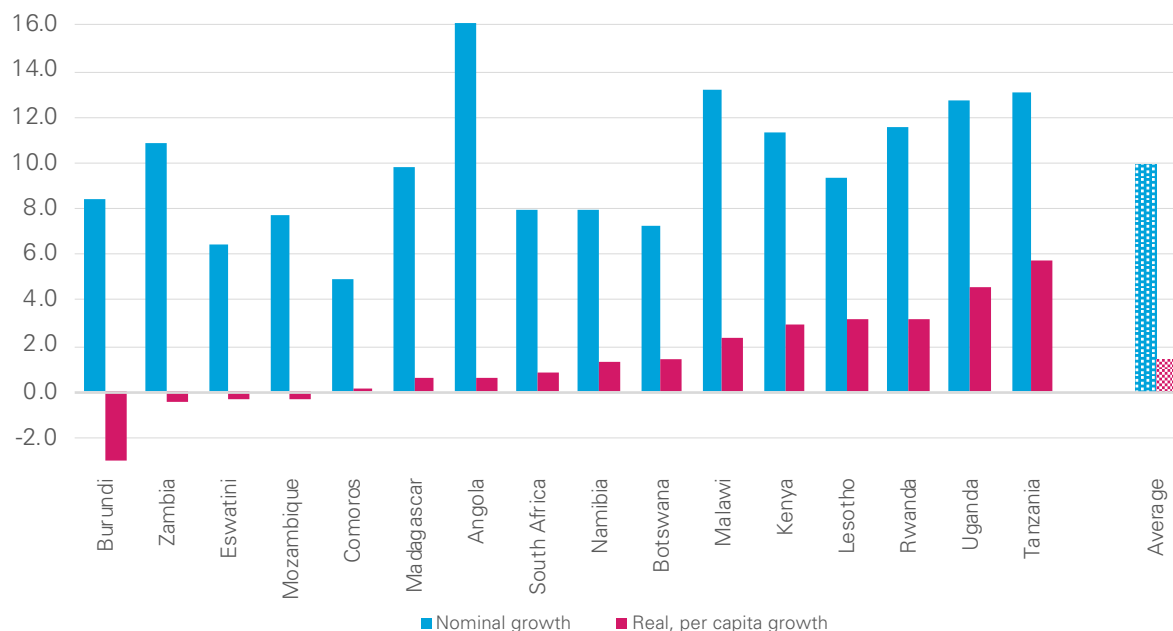
¹⁶ These changes built on those introduced into the baseline scenarios as summarized in Section 2.5.

Figure 2.09. Nominal and real per capita general government revenue, 2019-21 (as %, average of 16 countries)



Source: Author's calculations based on IMF World Economic Outlook Database (October 2018).

Figure 2.10. Nominal and real per capita general government revenue trends, 2019-21 period average projections (annual average percentage change)



Source: Author's calculations based on IMF World Economic Outlook Database (October 2018).

their human capital budgets, which are projected to grow 5-6 per cent annually in real per capita terms over the 2019-21 period.

If breaking down overall revenue flows, a prominent option for increasing expenditure on human capital sectors is greater tax collection. This could result from any combination of introducing new taxes, increasing current rates, reducing exemptions, and/or strengthening compliance and enforcement. In the group of countries studied, the ability of governments to extract taxes from the economy has wavered and trended downward in recent years (Figure 2.11a). As a sample average, total tax collection reached over 24 per cent of GDP in 2012, but has since steadily declined, falling below 20 per cent in 2016, the latest year with comparable data for most countries.

At the country level, there is a wide variance of tax collection capacity. Largely due to transfers received from the Southern African Customs Union, tax revenue in Eswatini, Lesotho, Namibia and South Africa has recently averaged near or above 30 per cent of GDP (Figure 2.11b). In contrast, tax revenue has been closer to 10 per cent of GDP in countries like Angola, Burundi, Madagascar and the United Republic of Tanzania.

The country studies confirm the opportunities presented by natural revenue growth and improved tax collection efforts. While the revenue generated from economic growth (or lack thereof) was one of the main determinants of the projected changes in per child expenditure on human capital as earlier shown in Figure 2.08, strong potential is also demonstrated by the alternative scenarios. All 16 studies looked at the possibility of different tax approaches to enhance funding. These included strengthening the efficiency of collection efforts and/or of increasing the rates of value added tax (VAT) on domestic products (13 countries¹⁷), VAT on imports (9 countries¹⁸), corporate income taxes (CITs) (7 countries¹⁹), personal income taxes (PITs) (5 countries²⁰), alcohol and tobacco taxes (2 countries²¹), fuel taxes (1 country²²) and mining royalties (1 country²³) as well as increasing the efficiency of tax collection at subnational levels (1 country²⁴) and overall tax administrative capacity (1 country²⁵). In total, 24 taxation scenarios were modelled,²⁶ although most scenarios combined multiple approaches (e.g. improving domestic and import VAT along with increasing CIT rates).

The modelling results indicate that taxes are a strong channel to boost human capital investment. If taking the most promising tax scenario from each of the 16 country studies and directing all new resources to human capital sectors, per child expenditure could increase by an average of around US\$23 above the baseline scenario after five years, which amounts to a 10 per cent improvement in real terms (Figure 2.12). For instance, a combination of approaches in Malawi, including gradually enhancing the efficiency of VAT, PIT and CIT collection by 50 per cent over the projection period, could raise real per child expenditure on human capital by more than 30 per cent above the baseline scenario. Elsewhere, improving tax collection capacity at the county level in Kenya could increase real per child expenditure by 16 per cent, while minimally raising the tax rates on alcohol and tobacco products in Lesotho – from 15 to 19 per cent – could generate a 2 per cent real increase in per child expenditure.

17 In Angola, Botswana, Comoros, Kenya, Madagascar, Malawi, Mozambique, Namibia, Rwanda, South Africa, Uganda, the United Republic of Tanzania and Zambia.

18 In Comoros, Kenya, Malawi, Mozambique, Rwanda, South Africa, Uganda, the United Republic of Tanzania and Zambia.

19 In Botswana, Eswatini, Kenya, Lesotho, Malawi, Namibia and South Africa.

20 In Botswana, Eswatini, Lesotho, Malawi and Namibia.

21 In Eswatini and Lesotho.

22 In Eswatini.

23 In Madagascar.

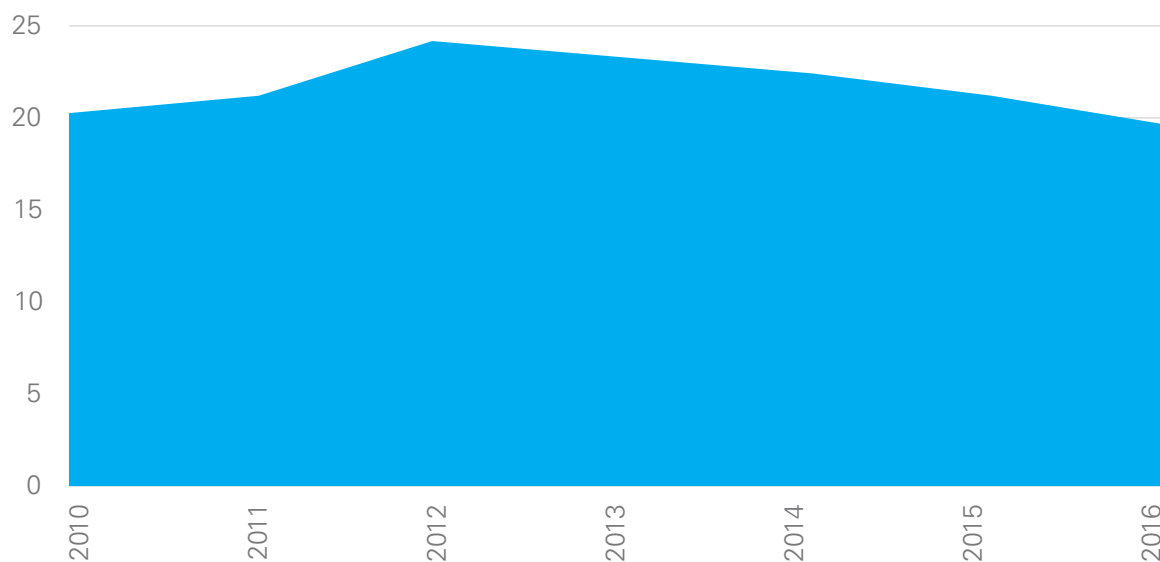
24 In Kenya.

25 In Burundi.

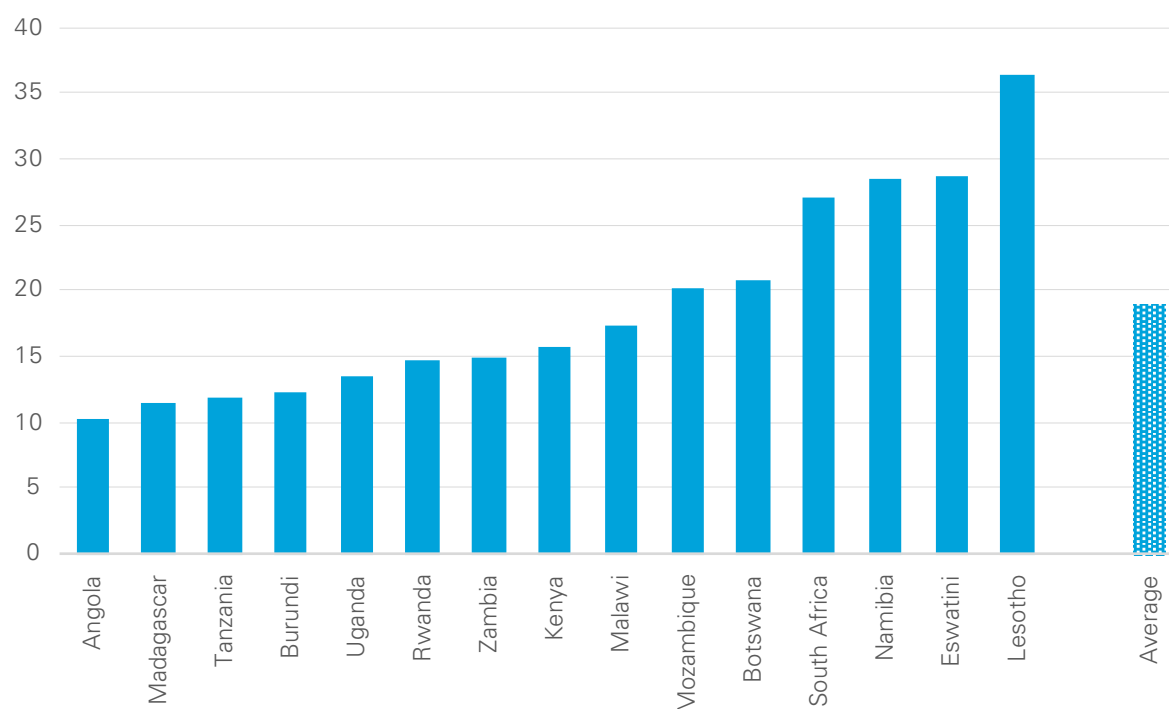
26 Six countries included multiple alternative scenarios on taxes.

Figure 2.11. Tax revenue trends (as % of GDP)

(a) 2010-16 (average of 16 countries)



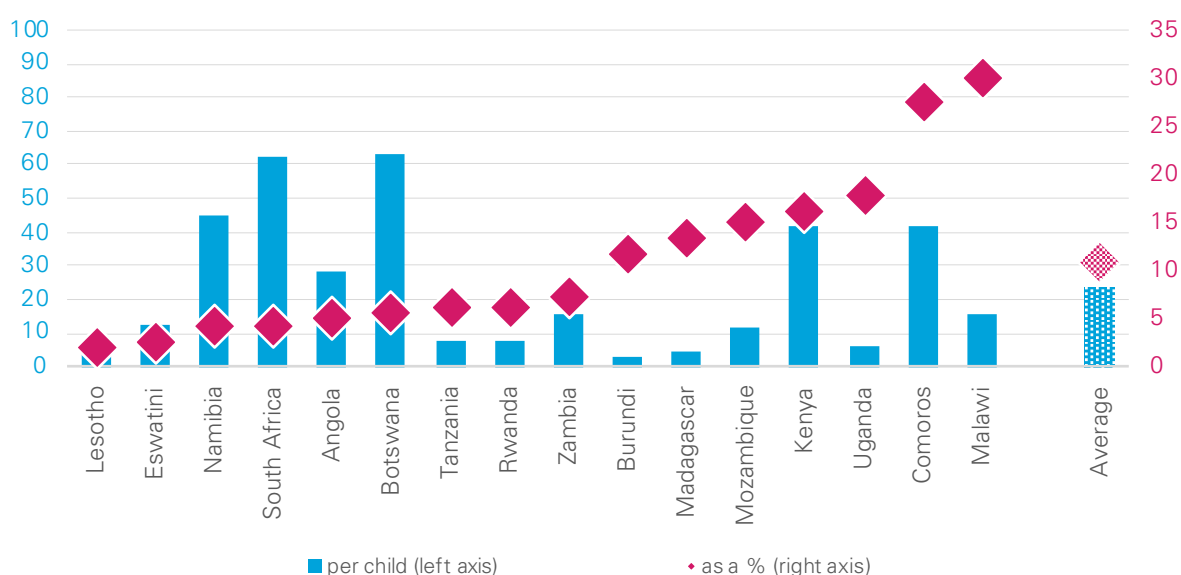
b) 2017 or latest available



Sources: IMF Government Finance Statistics Yearbook and data files, and World Bank GDP estimates.

Note: Comprehensive comparable data for this indicator is not available for all countries and all years, thus this average ignores specific countries in some years.

Figure 2.12. Potential additional impact of new tax revenue on human capital investments after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)



Source: Author's calculations based on modifications to country macro-fiscal programming models (see Annex 2).

Notes: Human capital investments are defined as those in education, health and social protection; the child population is all persons 0-17; the base year for constant US\$ and exchange rates varies across the sample.

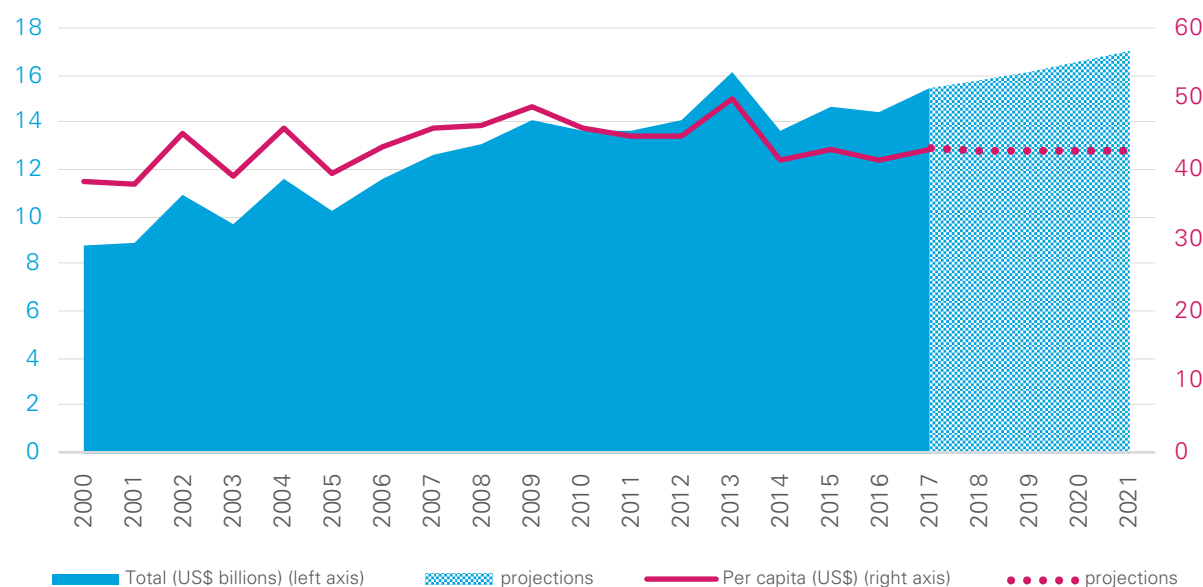
2.6.2. Increasing ODA

ODA flows to the 16 countries have grown modestly since 2014 but are expected to slightly decline on a per capita basis over the near term. After peaking in 2013 at US\$16.2 billion (in constant 2015 US\$) or around US\$50 per recipient, the total amount of grants and concessional financing fell to US\$13.7 billion or US\$41 per capita in 2014 (Figure 2.13). From then, the volume of ODA rebounded and increased by around US\$600 million annually until 2017, reaching US\$15.4 billion or about US\$43 on a per person basis. Looking forward, simple projections suggest that the recent upward trend could be maintained through 2021 with total ODA flows to the 16 countries in the US\$16-17 billion range. While this would represent an increase of close to 10 per cent from 2017 levels in aggregate numbers, per capital levels would remain constant.

At the country level, the impact of ODA on human capital expenditure is expected to vary over the near term. Looking at the 16 countries studied, simple projections indicate that the scale of support over the 2019-21 period will increase by an average of around US\$8 a year on a per recipient basis (in constant 2015 US\$), relative to the 2016-18 period (Figure 2.14). However, foreign aid is expected to decline in about half of the sample, including Angola, Burundi, Mozambique and South Africa (US\$5-11 average annual decreases in per capita terms). In other contexts, ODA flows may rise. For instance, when comparing 2016-18 and 2019-21, per capita ODA could increase by as much as US\$30 in Malawi and US\$40 in Eswatini and Lesotho.

The modelling exercises confirm that ODA provides a good opportunity to boost human capital investments in some countries. In the regional context of declining or stagnating flows on a per recipient basis, just six of the 16 country studies incorporated this type of alternative scenario, including most LICs along with one LMIC (Angola). Based on this

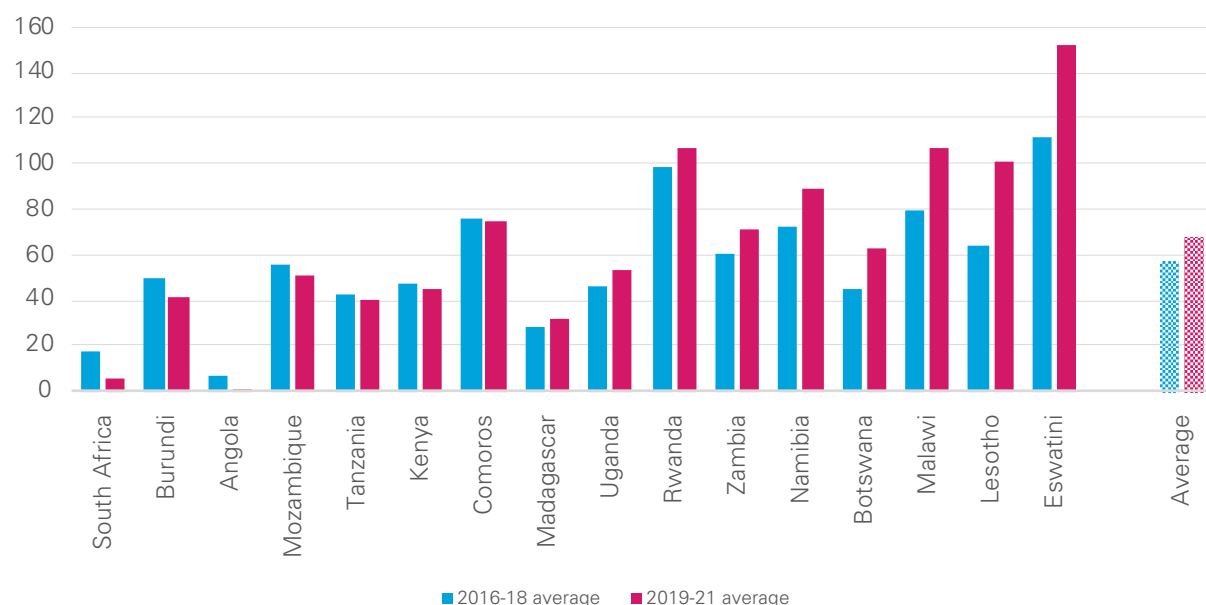
Figure 2.13. Net ODA and official aid trends, 2000-21 (in billions and per capita constant 2015 US\$, total and average of 16 countries)



Sources: Author's calculations based on Organisation for Economic Co-operation and Development (OECD) International Development Statistics online database (December 2018 update) and UN DESA World Population Prospects: 2017 Revision (medium variant estimates).

Note: Projections start in 2018 based on least squares method using the latest three-year period.

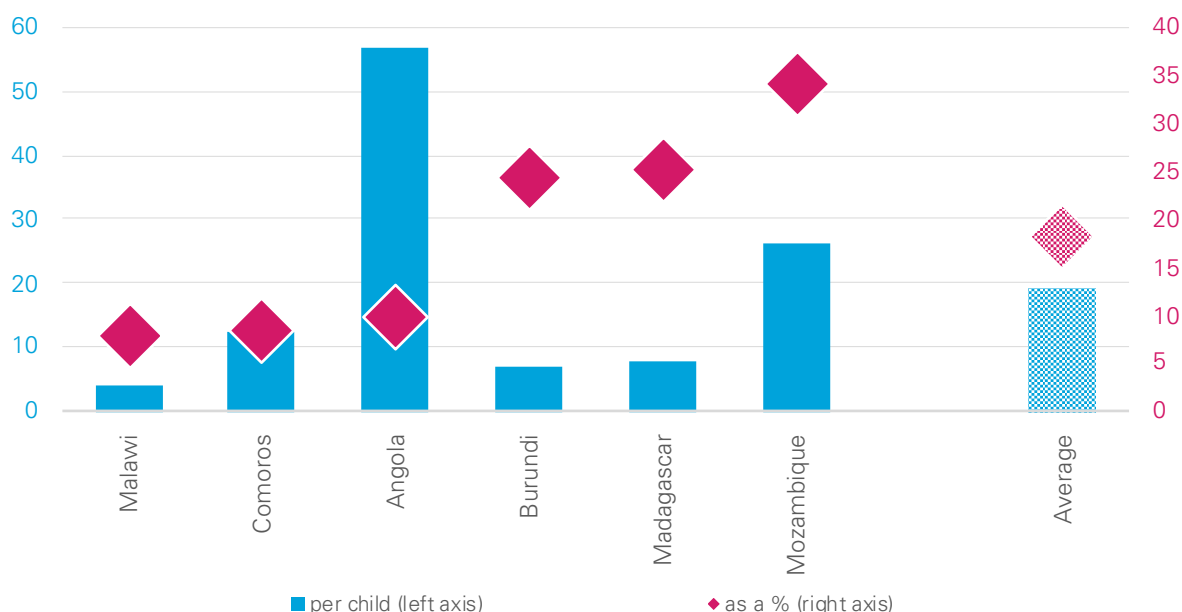
Figure 2.14. Trends in net ODA and official aid per capita, 2016-18 and 2019-21 period averages (in constant 2015 US\$)



Sources: Author's calculations based on OECD International Development Statistics online database (December 2018 update) and UN DESA World Population Prospects: 2017 Revision (medium variant estimates).

Note: Projections start in 2018 based on least squares method using the latest three-year period.

Figure 2.15. Potential additional impact of increased ODA on human capital investments after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)



Source: Author's calculations based on modifications to country macro-fiscal programming models (see Annex 2).

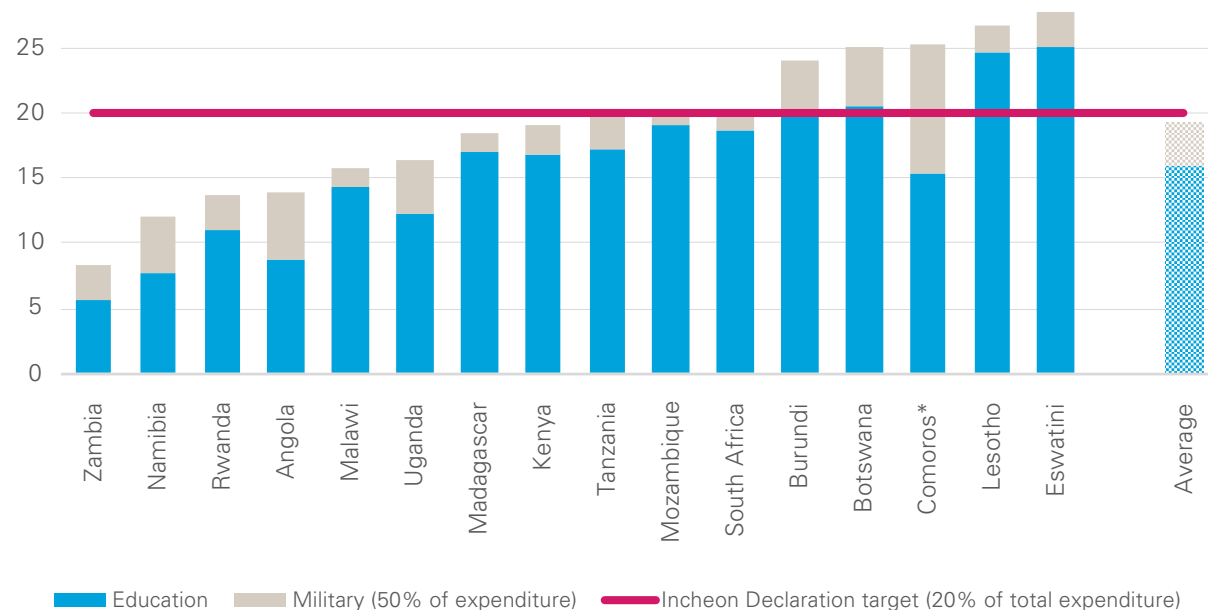
Notes: Human capital investments are defined as those in education, health and social protection; the child population is all persons 0-17; the base year for constant US\$ and exchange rates varies across the sample. Note: Projections start in 2018 based on least squares method using the latest three-year period.

sample, efforts to attract more ODA for human capital sectors could increase per child expenditure by an average of US\$19, or an 18 per cent real increase above the projected baseline values after five years (Figure 2.15). Of all the alternative scenarios, one from Mozambique showed the greatest promise. If the government could successfully lobby for an increase of external grants by 20 per cent over a five-year period, per child expenditure on human capital be more than 30 per cent greater than the baseline scenario level in real terms. In Burundi and Madagascar, a larger than expected volume of external grants could see per child expenditure rise by around 25 per cent above the baseline scenario in real terms after five years. And in Malawi, if external grants reached 4 per cent of GDP at the end of the projection period rather than 3.4 per cent of GDP under the baseline scenario, real per child expenditure could be around 8 per cent higher.

2.6.3. Reprioritizing spending

A seemingly easy yet politically complex way to increase investment in human capital sectors is to shift the orientation of the national budget. Some of the most commonly cited examples are reallocating resources away from non-priority sectors, such as national defence, or from subsidies that distort the economy (e.g. for state-owned enterprises) or have regressive impacts (e.g. fuel subsidies, which mainly benefit the wealthiest populations). In practice, the potential for reprioritization depends on a variety of circumstances in each country, especially politics. And while it is challenging to obtain cross-country comparable information to pinpoint specific opportunities, recent data on military expenditures offers one such lens. This is considered a decent illustration since only 3 out of 16 countries studied (Burundi, Kenya and Uganda) have been directly involved in a conflict in the past

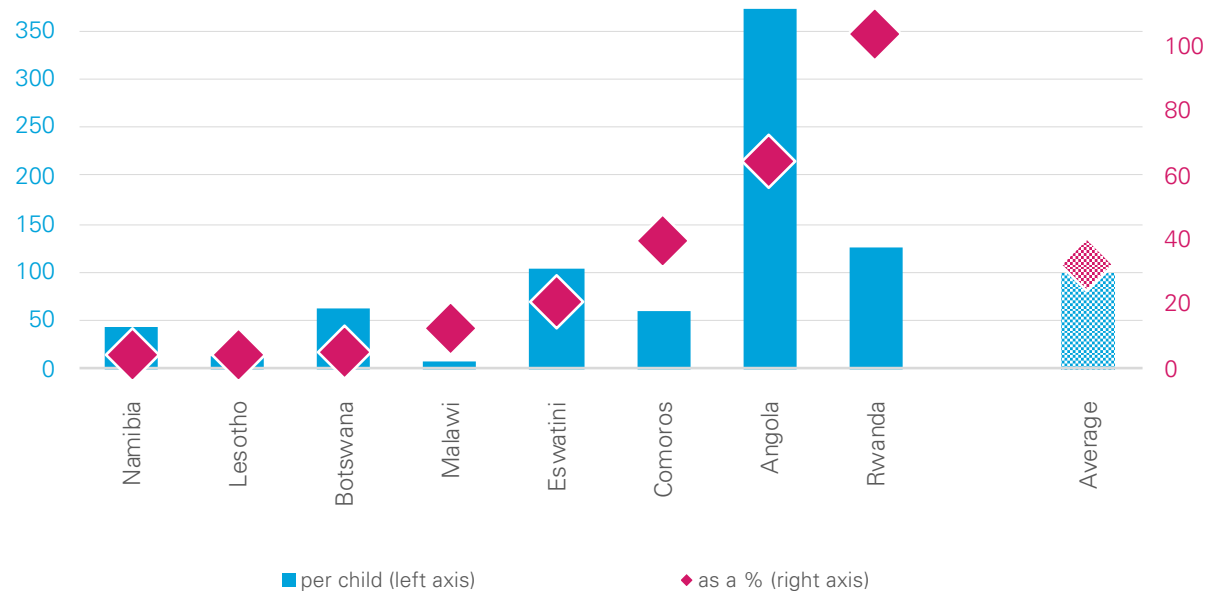
Figure 2.16. The impact of reallocating 50% of military expenditure to education, 2017 (or latest available) (as % of total expenditure)



Sources: Stockholm International Peace Research Institute Military Expenditure Database for data on military expenditure and UNESCO Institute for Statistics for data on education expenditure.

* Based on Institut National de la Statistique et des Etudes Economiques et Demographiques (2017) Memoire Budgetaire Global 2016/17.

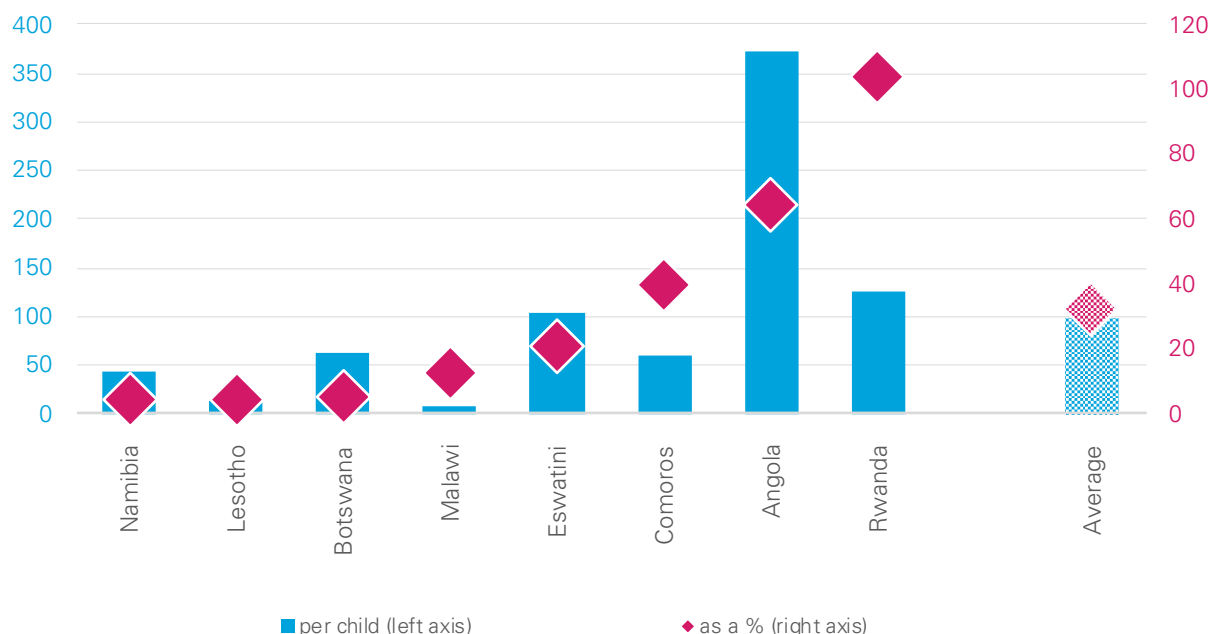
Figure 2.17. The impact of reallocating 50% of military expenditure to health, 2017 (or latest available) (as % of total expenditure)



Sources: Stockholm International Peace Research Institute Military Expenditure Database for data on military expenditure and WHO Global Health Expenditure Database for data on health expenditure.

* Based on Institut National de la Statistique et des Etudes Economiques et Demographiques (2017) Memoire Budgetaire Global 2016/17.

Figure 2.18. Potential additional impact of budget reprioritization on human capital investments after a five-year projection period compared to the baseline scenario



Source: Author's calculations based on modifications to country macro-fiscal programming models (see Annex 2).

Notes: Human capital investments are defined as those in education, health and social protection; the child population is all persons 0-17; the base year for constant US\$ and exchange rates varies across the sample.

ten years or face an imminent external threat,²⁷ which makes it difficult to rationalize large military budgets in most contexts.

By reallocating 50 per cent of recent military budgets, most governments in the sample could easily achieve core human capital spending benchmarks. The impact can be observed by comparing the change to expenditure on education and health as shown earlier in Figure 2.06. For instance, if half of military expenditure had been redirected to the education sector in 2017, education as a share of total expenditure would have increased from 15.9 to 19.2 per cent, on average, which means that eight countries would have fulfilled their commitment to the Incheon Declaration, up from three (Figure 2.16). Applying the same approach to health shows that 10 countries would have achieved the Abuja Declaration target, up from 2, with health expenditure rising from 11.7 to 15 per cent of total expenditure (Figure 2.17). Of course, the effects would be much more pronounced if the entire military budget were reallocated, whereby 10 countries would meet the education target and 13 the health target.

The country modelling exercises also validate the hypothesis that reprioritization could be a very robust option to scale up human capital investments in many countries. Of the eight studies that included this type of alternative scenario, expenditure levels were predicted to be US\$88 per child higher than the baseline scenario after a five-year period, on average, or a 28 per cent increase in real terms (Figure 2.18). If the Government of Rwanda was able to encourage greater funding from the private sector to support its ambitious infrastructure projects and progressively shift those projected public resources to human capital sectors, per child expenditure could more than double in real terms when compared to the predicted levels of expenditure under the baseline scenario after five years. In Lesotho,

²⁷ Uppsala Conflict Data Program (UCDP). *Armed Conflict Dataset version 18.1*. Available at: <https://ucdp.uu.se/downloads/>.

a combination of progressively eliminating fuel subsidies and retraining and redeploying security personnel to work in human capital sectors could raise real per child expenditure levels 5 per cent higher than the baseline scenario after five years. And in Comoros and Eswatini, reallocating resources from defence and public administration to human capital sectors could lift per child expenditure 40 per cent and 20 per cent respectively above the projected baseline levels after a five-year period.

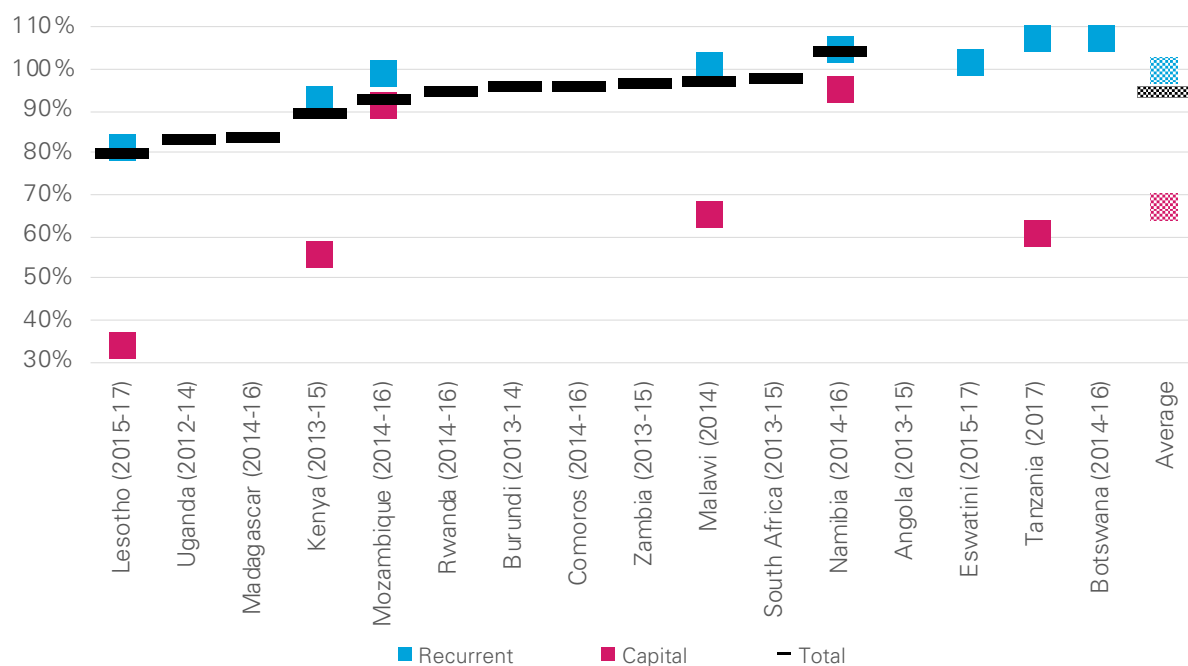
2.6.4. Improving the efficiency of spending

A major opportunity for many governments to increase investment in human capital sectors is to ensure that available resources are actually spent. One way to measure spending efficiency is through budget execution rates, which show the difference between the amount of resources released to a spending agency during a fiscal year and the amount of resources that are used by the end of that year. If the budget execution rate is less than 100 per cent, this means all of the funds that were made available during the year were not spent. In many cases, unutilized funds are given to other ministries that can readily spend the resources before the end of the fiscal year or, alternatively, returned to the Ministry of Finance (MoF) or Treasury. In either case, resources that were available in a human capital sector are, in effect, “lost.” As a result, improving budget execution performance can directly boost investment levels.

Data on budget execution is not systematically collected and reported in global databases, which limits this type of analysis. A select number of studies do provide data points, but this does not allow for comprehensive analysis. In contrast, budget credibility rates – which show the variance between the approved budget at the start of the fiscal year and the amount of resources spent by the end of the year – are more widely captured. Although these indicators are fundamentally different – i.e. a ministerial budget can have a very low budget credibility rate alongside a very high budget execution rate – poor performance in one area tends to be associated with poor performance in the other, especially over time. This is at least partially driven by the similarity of underlying challenges, which can range from weak budget planning and human resources capacity to delayed disbursement flows, poor cash management practices, complex procurement processes and so on. Thus, while budget credibility is an imperfect measure of the amount of available resources that may be “lost” each year due to certain spending inefficiencies, it can serve as an acceptable proxy for illustrative purposes.

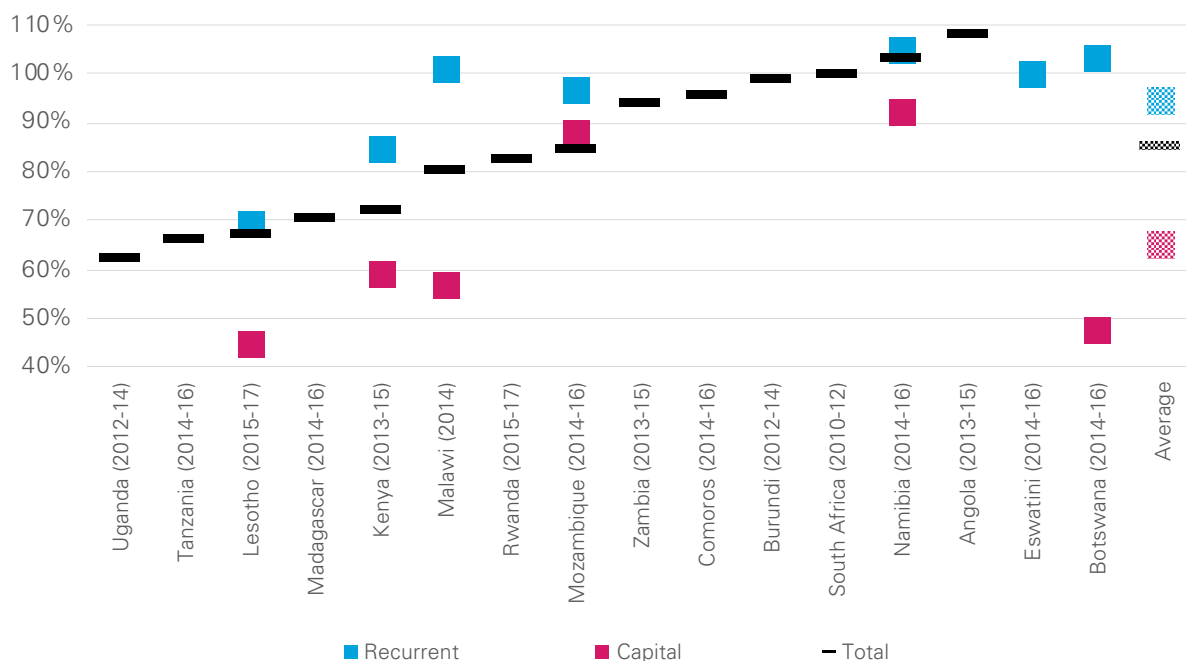
Budget credibility trends suggest that most countries studied show strong potential to increase actual investment in human capital areas. A review of different public finance analyses, including UNICEF budget briefs, Public Expenditure Reviews (PERs), Public Expenditure and Financial Accountability (PEFA) reports and World Bank BOOST databases, provides at least some information for all 16 countries on the education and health sectors. The data vary by country, covering a mix of credibility rates for recurrent, capital and overall expenditure, as well as across different fiscal years. Nonetheless, when looking at the latest three-year average of available data points for each country, 94 per cent of the approved amount of education budgets is spent by the end of the fiscal year, as a regional average (Figure 2.19). Recurrent expenditure performs much better (99 per cent on average) than capital expenditure (67 per cent on average), but notable differences are observed across countries. For instance, the latest three-year average credibility rate for the recurrent education budget was 81 per cent in Lesotho compared to 107 per cent in the United Republic of Tanzania, while for capital budgets it was 34 per cent in Lesotho and 95 per cent in Namibia. Turning to the health sector, credibility trends are remarkably similar. Specifically, the latest three-year average recurrent and capital budget credibility rates were 94 and 65 per cent respectively, with the overall rate at 85 per cent on average (Figure 2.20).

Figure 2.19. Education budget credibility rates, latest available 3-year period averages (actual expenditure as % of approved allocation)



Sources: Author's calculations based on UNICEF budget briefs, PERs, PEFA reports and World Bank BOOST databases published since 2016.

Figure 2.20. Health budget credibility rates, latest available 3-year period averages (actual expenditure as % of approved allocation)



Sources: Author's calculations based on UNICEF budget briefs, PERs, PEFA reports and World Bank BOOST databases published since 2016.

The application of a simplified model can enable estimation of the volume of human capital resources “lost” due to underspending. For example, aligning total budget credibility rates to education and health expenditure data in the same fiscal years makes it possible to calculate the additional volume of resources that could have been spent had budget credibility rates reached 100 per cent in each sector. The caveats of this methodology are significant and underlined by the use of budget credibility rather than execution data, which erroneously assumes the rates to be identical. Nonetheless, bearing the assumptions and data limitations in mind, this approach does offer a very preliminary picture of “lost” fiscal space.

A very rough approximation is that billions of dollars of available human capital resources are “lost” each year due to certain spending inefficiencies. Among the 14 countries that have data on overall budget credibility rates for the education and health sectors in recent years, the combined “lost” amount of these core human capital resources exceeded US\$8 billion annually (in purchasing power parity or PPP, current international \$) (Figure 2.21a). To get a better sense of the magnitude of potential loss, this would equal more than 55 per cent of the entire annual ODA flows to those 14 countries. At the country level, this is somewhere around US\$200 million a year in Malawi and Rwanda, US\$400 million in Lesotho and Madagascar, US\$500 million in Mozambique, US\$1 billion in South Africa and Uganda, US\$1.6 billion in the United Republic of Tanzania and US\$2.7 billion in Kenya. In per capita terms, nearly US\$30 per capita (in PPP, current international \$) of human capital investments were “lost” as a sample average, which reaches more than US\$60 per capita in Kenya and nearly US\$200 per person in Lesotho (Figure 2.21b).

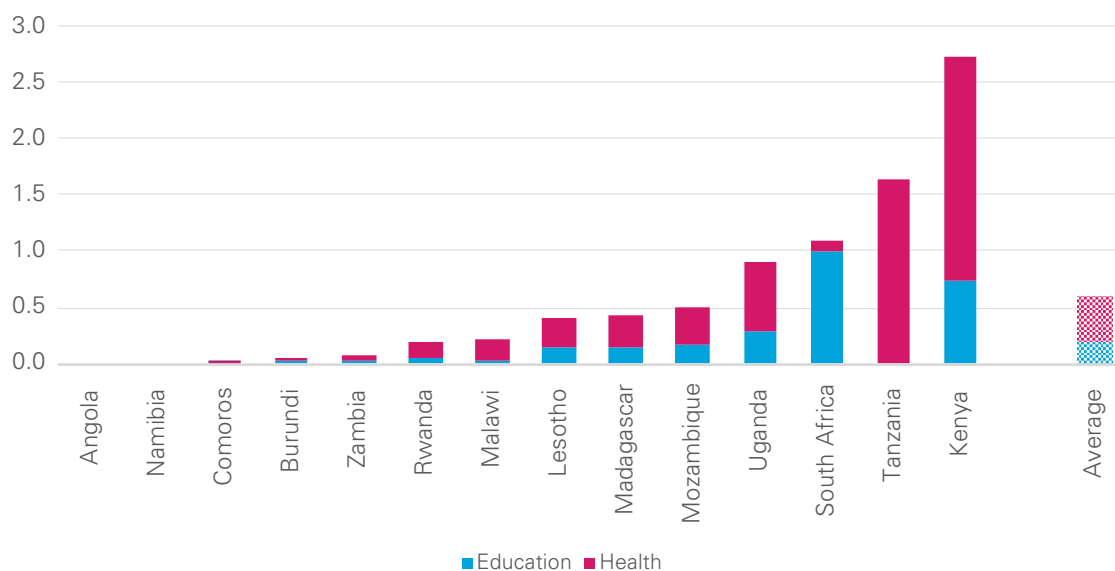
The limited information from the country studies validates the prospects suggested by the regional trends. As earlier described, the difficulties in obtaining data on budget execution prevented a more comprehensive assessment of this option, which was discussed in nearly all studies but only modelled in three countries. A review of this limited sample indicates that efforts to strengthen budget execution rates in human capital sectors could potentially increase per child expenditure by an average of US\$22 (in constant US\$), above the baseline projections after five years or around a 10 per cent increase in real terms (Figure 2.22).

Although limited, the available modelling exercises illustrate the potential gains from addressing budget execution weaknesses. In Kenya, if budget execution rates progressively reached 100 per cent in the education and health sectors rather than continuing at the 90 per cent in the baseline scenario, per child expenditure could be more than 20 per cent higher in real terms after five years (also Figure 2.22). In Burundi, an alternative scenario looked at improving budget execution rates in the education sector above the baseline scenario, from 70 to 80 per cent for recurrent spending and from 50 to 65 per cent for capital spending. With these relatively modest ambitions, it is estimated that after a five-year period, real per child expenditure could increase by more than 10 per cent. And in Eswatini, as recurrent spending performed strong across the board, an alternative scenario focused on strengthening capital budget execution rates in the education, health and social welfare sectors. Here, doubling execution rates beyond those in the baseline scenario was projected to produce an additional US\$16 per child after five years, or a 3 per cent overall increase in real terms.

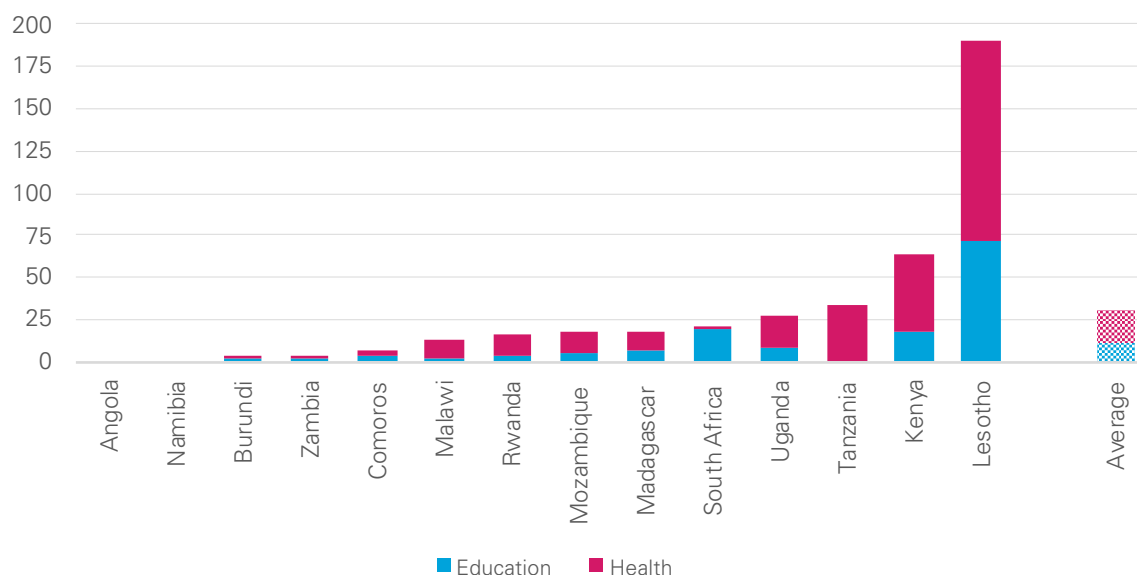
Beyond budget execution, another type of spending inefficiency is wastage, which may also present opportunities to enhance the impact of resources already released to human capital sectors. Wastage can occur when services or benefits are provided multiple times to the same person (contrary to rules) or to persons who are ineligible to receive them. Given the parameters and the short duration of the in-country work, this issue was difficult to reveal in most studies. However, Lesotho did offer some insights. There, both categories of wastage were identified in the social protection sector. On the one hand, registration

Figure 2.21. Crude estimates of “lost” education and health resources, latest available three-year period averages (in PPP, current international US\$)

(a) billions



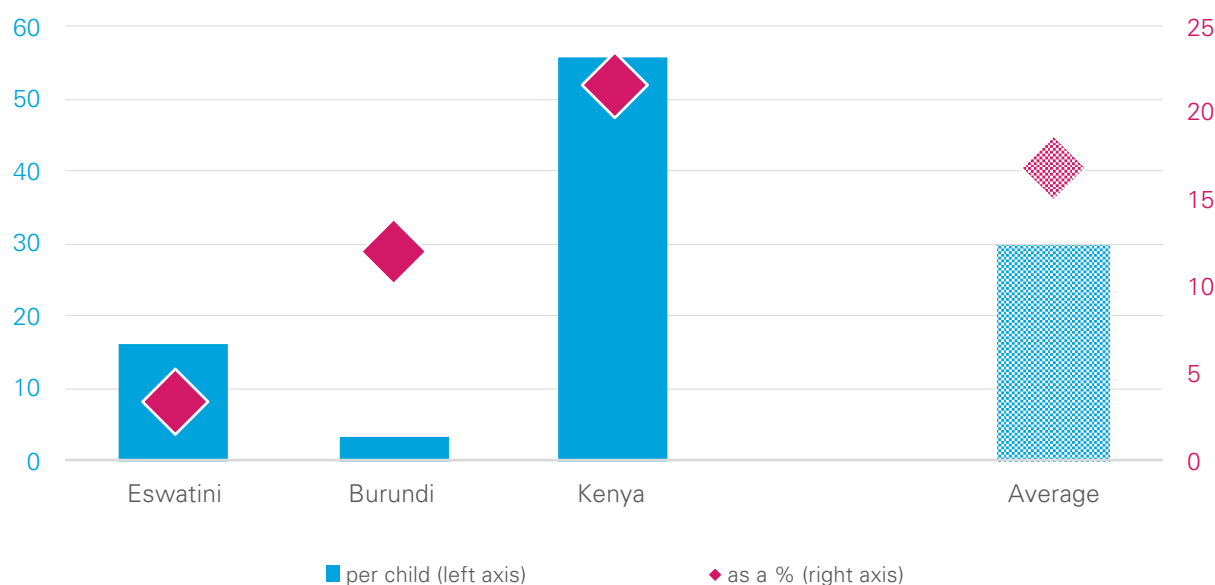
(b) per capita



Sources: Author's calculations based on total budget credibility rates for the education and health sectors (see Figures 2.16 and 2.17 for information on sources), education expenditure data from UNESCO Institute for Statistics, health expenditure data from WHO Global Health Expenditure Database, GDP data from IMF World Economic Outlook Database (October 2018), and population data from UN DESA World Population Prospects: 2017 Revision (medium variant estimates).

Note: Botswana and Eswatini were excluded since they did not have total budget credibility rates for the education or health sectors.

Figure 2.22. Potential additional impact of higher capital budget execution rates on actual human capital investment after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)



Source: Author's calculations based on modifications to country macro-fiscal programming models (see Annex 2).

Notes: Human capital investments are defined as those in education, health and social protection; the child population is all persons aged 0-17; the base year for constant US\$ and exchange rates varies across the sample.

challenges have resulted in a situation where many beneficiaries receive cash grants from multiple programmes, which is contrary to the design of the system. On the other hand, the number of citizens that receive old-age pensions is around 30,000 more than the actual number of elderly persons living in the country, which results when payments continue after the death of the recipients. By applying a simple estimation approach to the latter spending inefficiency, the Lesotho fiscal space analysis indicated that eliminating the “ghost” pensioners and redirecting those resources to child grants would allow the programme to cover nearly all children in the country, up from less than 20 per cent.

2.6.5. Borrowing and debt restructuring

Budget deficits have been the norm in recent years in the countries reviewed and are expected to continue over the near term. All governments have spent far beyond their income in recent years, amounting to 5 per cent of GDP as a period average for the sample (Figure 2.23). This trend is projected to continue over the 2019-21 period, meaning that governments are expected to run budget deficits and borrow from domestic and international markets to pay for the difference.

One primary concern is that structural budget deficits have caused government debt to soar across the sample. As a regional average, general government gross debt increased sharply in recent years, from around 30 per cent of GDP in 2012 to more than 50 per cent in 2018 (Figure 2.24). Over this period, debt levels increased by around 20 per cent of GDP in Eswatini, Namibia, Rwanda and Uganda, by around 50 per cent of GDP in Angola and Zambia, and by nearly 75 per cent of GDP in Mozambique. There are, however, two outliers: debt levels fell in Botswana and Comoros by around 6 per cent and 14 per cent of GDP respectively. Looking forward, general government gross debt is projected to

average 54 per cent over the 2019-21 period. Here, debt levels are expected to increase by an average of 5.8 per cent of GDP in 11 countries and to decrease by an average of 3.6 per cent of GDP in five countries. Debt is forecast to increase by 11 per cent or more of GDP in Burundi, Mozambique, Namibia and Zambia during the 2019-21 period and fall by about 11 per cent of GDP in Angola.

Nonetheless, in some cases governments may have flexibility to borrow over the near term to support investment in human capital. The most obvious cases are the LICs in the sample that are considered to have a low risk of debt distress, which include Lesotho, Rwanda, Uganda and the United Republic of Tanzania (Figure 2.25). If looking further at core debt distress indicators, these countries demonstrate additional borrowing capacity, especially from external sources. The IMF's latest debt sustainability framework for LICs²⁸ updated its approach for assessing debt distress, which included the creation of a Composite Index (CI) that goes beyond the Country Policy and Institutional Assessment (CPIA) to assess borrowing capacity, as well as adjusting benchmark levels for different indicators. Since the Fund had not yet released a database of CI values at the time of writing, applying the latest CPIA values as a proxy for borrowing capacity and looking at the corresponding debt distress thresholds for two key indicators – the present value of debt as a percentage of GDP and as a percentage of exports – suggests that all countries except Mozambique have external debt loads far below the thresholds (Figures 2.26 and 2.27). Here, the obvious limitation is that external debt constitutes only a small proportion of debt in most countries, which have principally relied on domestic markets to meet borrowing needs. This landscape, however, could change quickly for some countries, especially as they reach middle-income status and/or maintain strong economic growth outlooks.

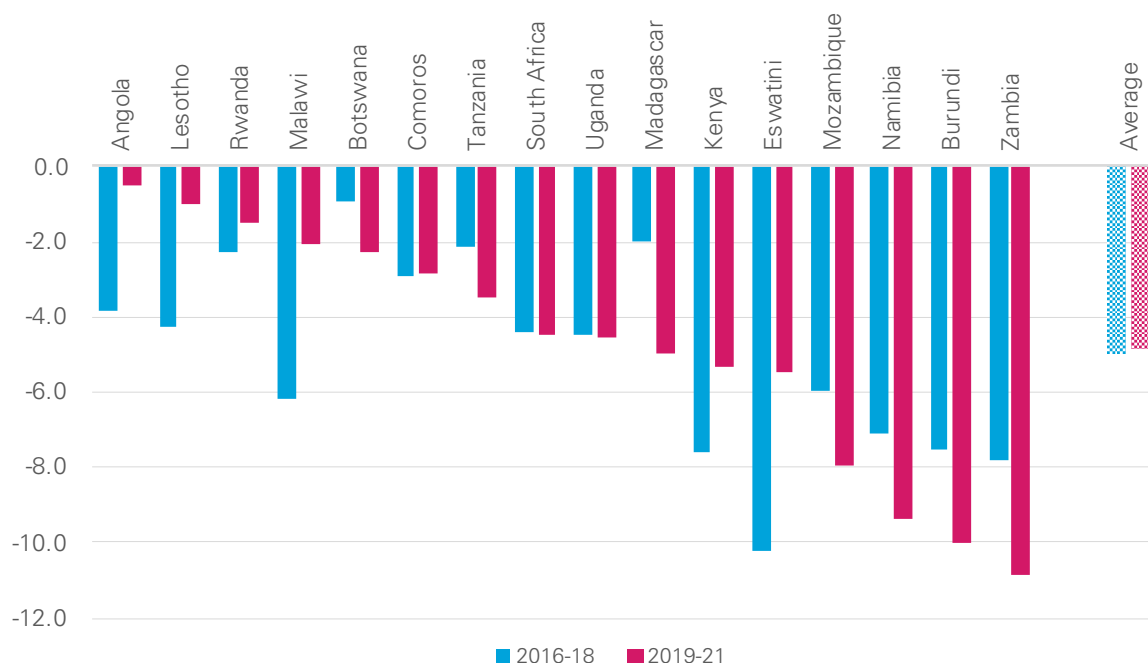
Another potential opportunity for some governments is to lower debt servicing costs, which would allow for those resources to be redirected to support greater spending on human capital sectors. By meeting with creditors, governments could restructure their current debt obligations, either by refinancing on more favourable terms or by negotiating lower interest rates and/or later maturity dates. Voluntary negotiations have been quite common, with more than 60 governments successfully restructuring debt between 1990 and the early 2000s.²⁹

Turning to the modelling exercises, there was evidence of some potential for borrowing to fund greater human capital investments among a small group of countries. Looking at the four countries that included this alternative scenario, different borrowing arrangements could increase funding for human capital sectors by an average of around US\$10 per child above the amount projected in the baseline scenario after five years, or a 14 per cent real increase (Figure 2.28). In Malawi, if external debt disbursements remained stable at 3 per cent of GDP rather than falling to 2.5 per cent of GDP under the baseline scenario, per child expenditure was estimated to be nearly 40 per cent higher in real terms after five years. In Comoros, a non-concessional loan to support investment in the health sector, including to construct a new hospital, was projected to improve real per child expenditure by close to 10 per cent above the baseline scenario after five years. And if domestic financing reached 0.2 and 0.15 per cent of GDP higher than the baseline scenarios in Uganda and the United Republic of Tanzania respectively, with the loan proceeds fully directed to human capital sectors, per child expenditure could rise by 7 and 2 per cent in real terms respectively. As a final note, re-negotiating debt repayment terms was discussed in many country studies, but this option was never modelled.

28 International Monetary Fund (IMF) (2017). *Review of the Debt Sustainability Framework in Low-Income Countries: Proposed Reforms*. IMF Policy Paper.

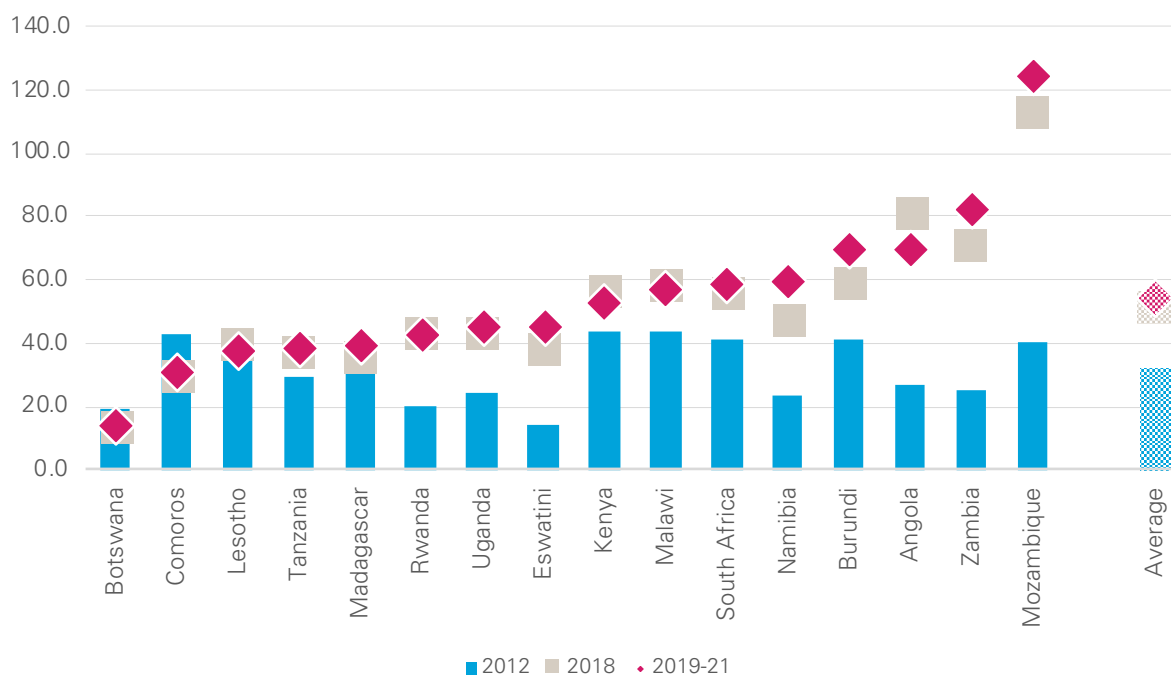
29 Bai, Y. and Zhangy, J. (2010). *Duration of Sovereign Debt Renegotiation*. University of Michigan Working Paper No. 593.

Figure 2.23. General government net borrowing, 2016-18 and 2019-21 period averages (as % of GDP)



Source: IMF World Economic Outlook Database (October 2018).

Figure 2.24. General government gross debt, 2012, 2018 and 2019-21 period average (as % of GDP)



Source: IMF World Economic Outlook Database (October 2018).

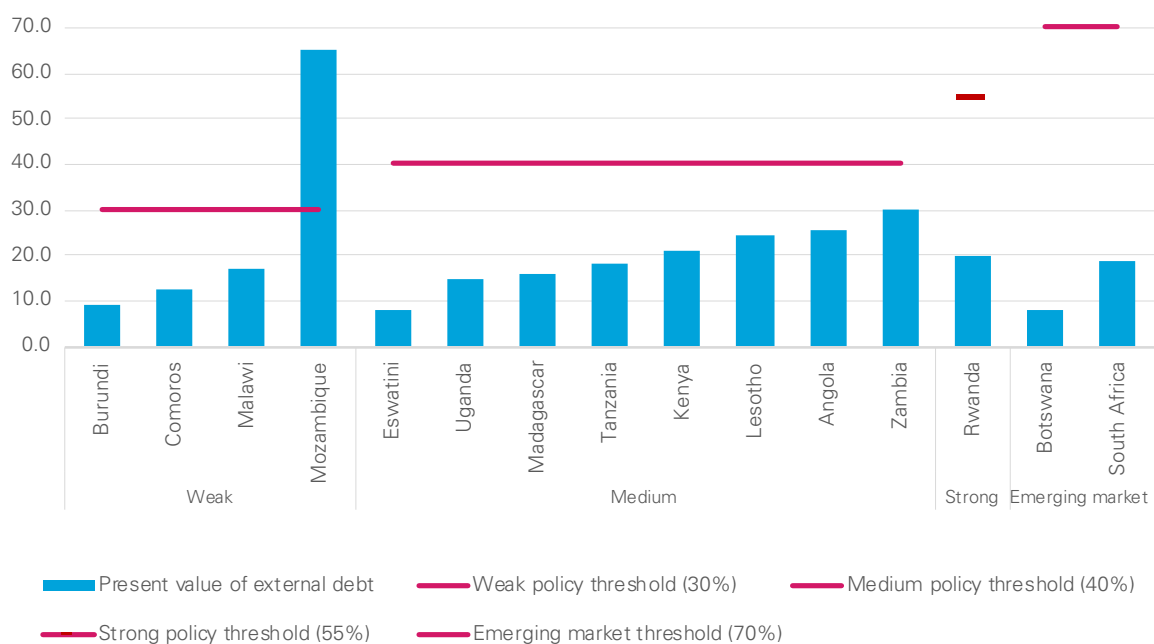
Figure 2.25. Risk of debt distress, latest available



Source: IMF (2018) "List of LIC DSAs for PRGT-Eligible Countries," Summary note based on a staff review of the latest DSAs as of 1 November 2018.

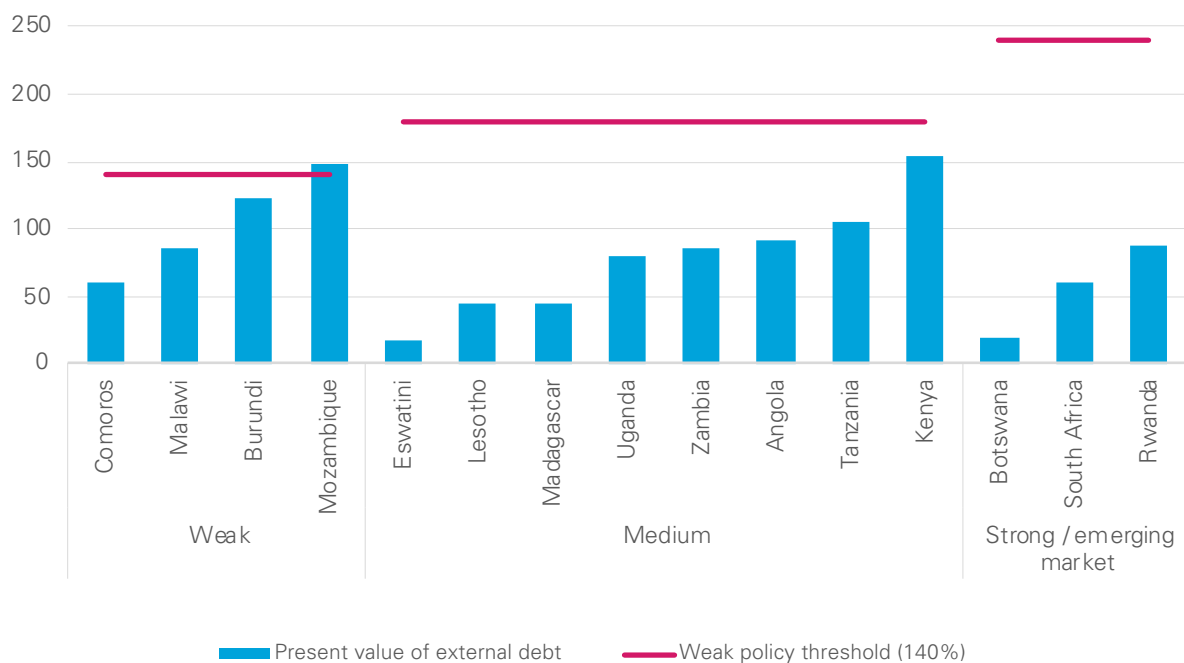
Note: DSAs have not recently been conducted in Angola, Botswana, Eswatini, Namibia or South Africa.

Figure 2.26. Present value of external debt and debt distress, 2017 (as % of GDP)



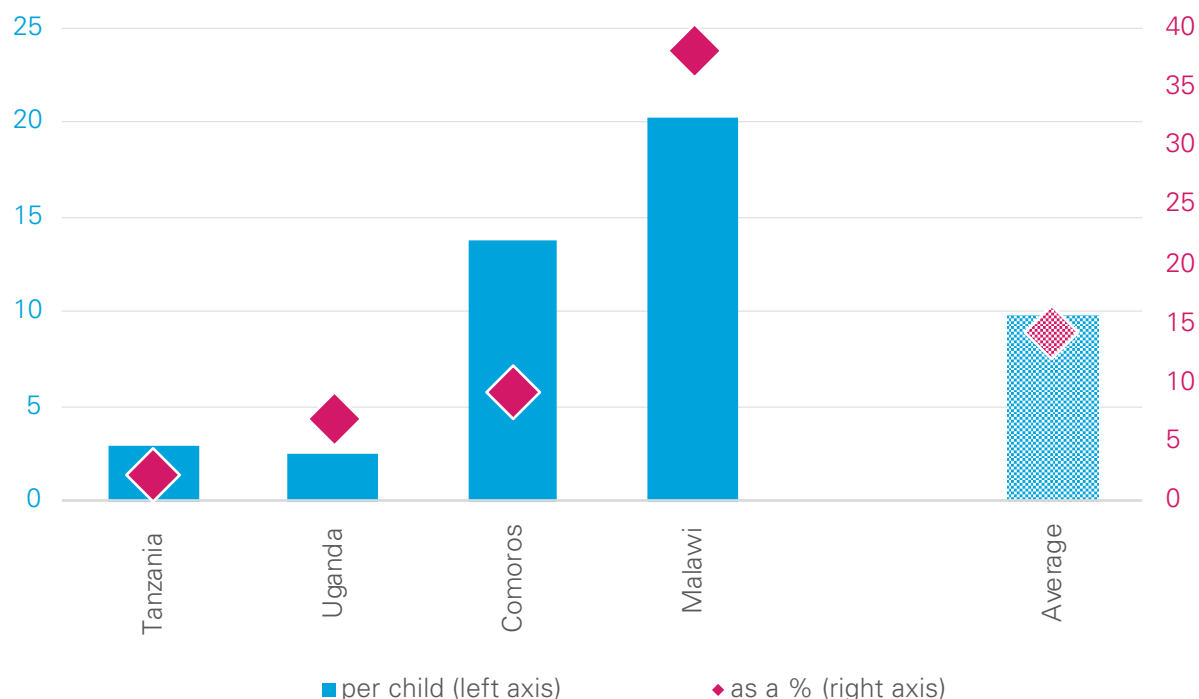
Source: IMF World Economic Outlook Database (October 2018).

Figure 2.27. Present value of external debt and debt distress thresholds in the 16 fiscal space countries, 2017 (as % of exports of goods, services and primary income)



Source: IMF World Economic Outlook Database (October 2018).

Figure 2.28. Potential additional impact of borrowing to increase human capital investments after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)



Source: Author's calculations based on modifications to country macro-fiscal programming models (see Annex 2).

Notes: Human capital investments are defined as those in education, health and social protection; the child population is all persons aged 0-17; the base year for constant US\$ and exchange rates varies across the sample.

2.6.6. Using fiscal savings

Several governments have fiscal savings invested in sovereign wealth funds that could be immediately accessed to finance greater spending on human capital sectors. Of the 16 countries studied, two currently have commodity-based sovereign wealth funds, which are state-owned investment funds designed to maximize financial returns, typically in international capital markets, as well as to sterilize foreign currency inflows to avoid appreciation of the national currency. This includes Angola, which has an estimated US\$4.6 billion of oil earnings stored in the *Fundo Soberano de Angola* (launched in 2012), and Botswana, which has around US\$5.5 billion of diamond revenue in the Pula Fund (launched in 1994).³⁰ In these cases, the logic of investing earned public income in capital market growth to spend in the future should be questioned when there are significant human capital deficits at present. As a simple illustration, if each country were to invest 10 per cent of their sovereign wealth holdings in the health sector in 2019, the total health budget could potentially increase by around 20 per cent in Angola and 90 per cent in Botswana; investing 25 per cent could boost the health sector budget by close to 50 per cent in Angola and by more than 200 per cent in Botswana.³¹

³⁰ Sovereign Wealth Fund Institute (2018). *Sovereign Wealth Fund Rankings*.

³¹ Author's calculations based on health expenditure data from the WHO's Global Health Expenditure Database, GDP data from the IMF's World Economic Outlook Database (October 2018) and sovereign investment data from the Sovereign Wealth Fund Institute (2018); assumes that health expenditure as a percentage of GDP remains constant between 2015 and

Other governments may soon be presented with similar opportunities, as several countries are gearing up to be significant natural resource exporters. Kenya, for example, initiated its first exports of crude oil from the northern region of Turkana in mid-2018 through a pilot trucking scheme, which will remain in place until a pipeline is built to the coast.³² As production scales, output is expected to reach around 80,000 barrels a day by 2022,³³ with the Sovereign Wealth Bill 2019 recently tabled to manage the resources.³⁴ In Mozambique, several liquefied natural gas (LNG) projects are under construction, with exports expected to begin in 2022.³⁵ Forecasts indicate that these could catapult the country into the world's sixth-largest producer of LNG and generate somewhere around US\$80 billion of revenue for the government over time.³⁶ In Uganda, oil exports are likely to start in 2021, with fields expected to produce up to 230,000 barrels a day at full production.³⁷ In 2015, a Petroleum Fund was established to facilitate the management of the new revenue and was recently tapped to support the budget in fiscal year 2018.³⁸ The United Republic of Tanzania has an estimated 57 trillion cubic feet of proven but largely undeveloped natural gas reserves, which could generate somewhere around US\$5 billion annually in LNG exports.³⁹ The main fields should become operational around 2025, and the government is envisaging the creation of an Oil and Gas Fund to manage the income.⁴⁰ Lastly in Zambia, while the government announced its intention to establish a sovereign wealth fund for its copper revenues back in 2014, this has yet to move forward.⁴¹

In the country studies, fiscal savings were discussed as options to increase investment in human capital but not modelled. For example, the Botswana report described the political difficulties of accessing resources from the Pula Fund, given the focus on maintaining fiscal buffers to support the country's economic adjustment strategy as mineral production declines over time. In Angola, it was noted that a maximum of 7.5 per cent of the sovereign wealth fund can be used to support social development programmes, although the mechanisms and beneficiaries remain unclear. And in Kenya, Mozambique, Uganda and the United Republic of Tanzania, the reports described the strong potential of sovereign wealth funds to support human capital investments at some point in the future. However, it was not possible to accurately model alternative scenarios over the medium term given uncertainties around the initiation and volume of production, as well as around how those future revenue flows will be managed.

2.6.7. Capturing and/or preventing illicit financial flows

Illicit financial flows (IFFs) are a major potential source of funding for investment in human capital in many of the countries studied. IFFs characterize money that is illegally earned, transferred or used that crosses borders and includes practices like mispricing traded goods, transferring money to shell companies abroad and non-reporting of

2019, that the IMF's GDP projections for 2019 are accurate and that the level of investment holdings as of November 2018 is the same in 2019.

32 Paraskova, T. (2018). *Kenya Starts Its First-Ever Crude Oil Exports*. Oil Price, 4 June.

33 Otieno, B. (2018). *Tullow Oil Projects Sh120 Billion Annual Revenue for Kenya*. The Star, 7 June.

34 Kamau, M. (2019). *State Banks on Oil Dollars to Pay Off Debt*. Standard Media Kenya, 14 February.

35 Daiss, T. (2019). *Can Mozambique Avoid the Natural Resource Curse?* Oil Price, 2 January.

36 Agencia de Informacao de Mocambique (2018). *Mozambique: Over 77 Billion Dollars in Taxes Expected From LNG*, 17 May.

37 Aglionby, J. (2017). *Uganda's Oil Reserves Bring Promise of Work and Infrastructure*. Financial Times, 27 April.

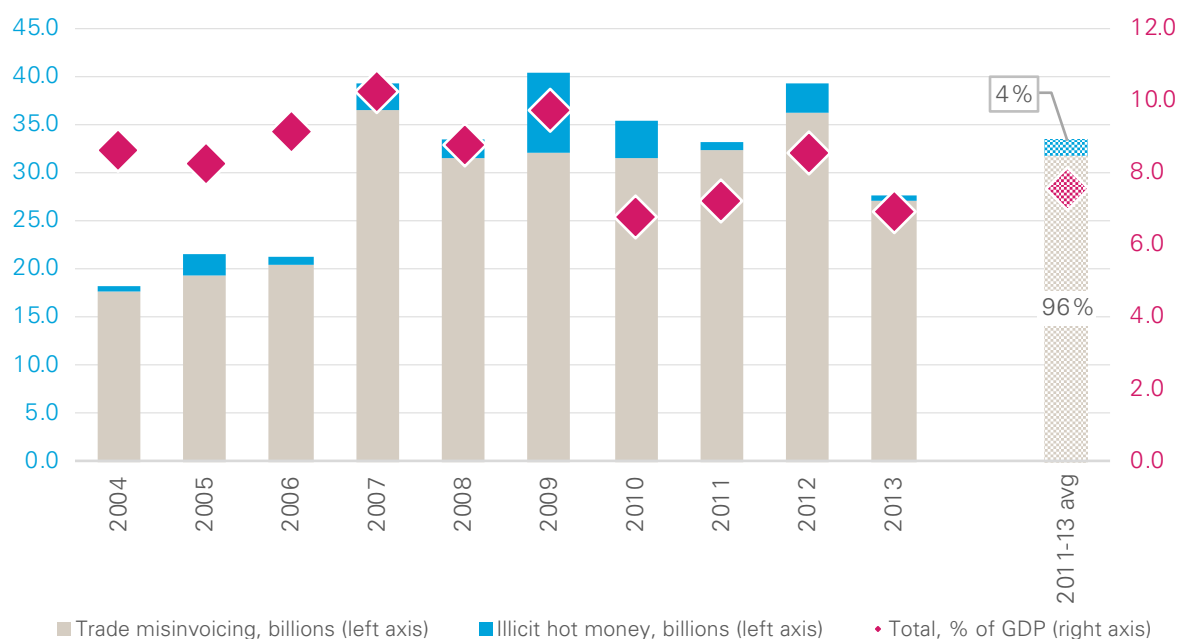
38 Wesonga, N. (2018). *Government Moves Shs125b from Petroleum Fund*. Daily Monitor, 3 April.

39 Bungane, B. (2018). *Tanzania: Use of Natural Gas Can Boost Economic Growth*. ESI Africa, 21 March.

40 Hussein, T. (2018). *Shell and Equinor Reaffirm Commitment to Tanzania LNG Project*. OffshoreTechnology.com, 16 October.

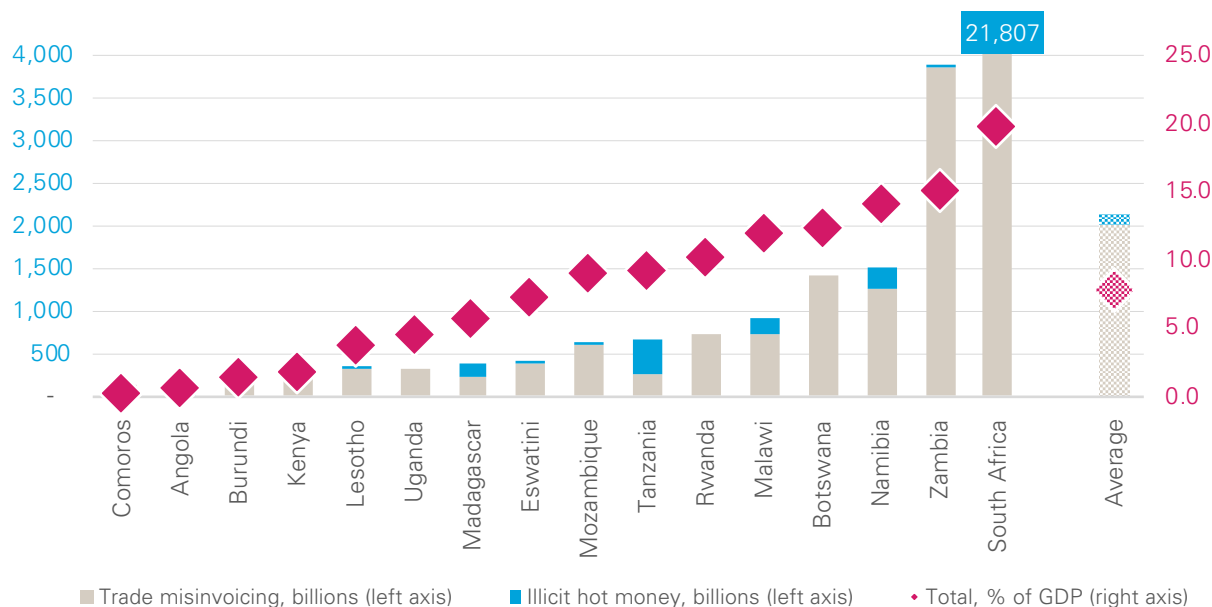
41 Chishimba, N. (2018). *A Zambian Sovereign Wealth Fund: Could it be the answer to our over-reliance on mining revenues?* Mining for Zambia, 19 September.

Figure 2.29. Trends in illicit financing flows, 2004-13 (in billions of current USD and as % of GDP, total and average of 16 countries)



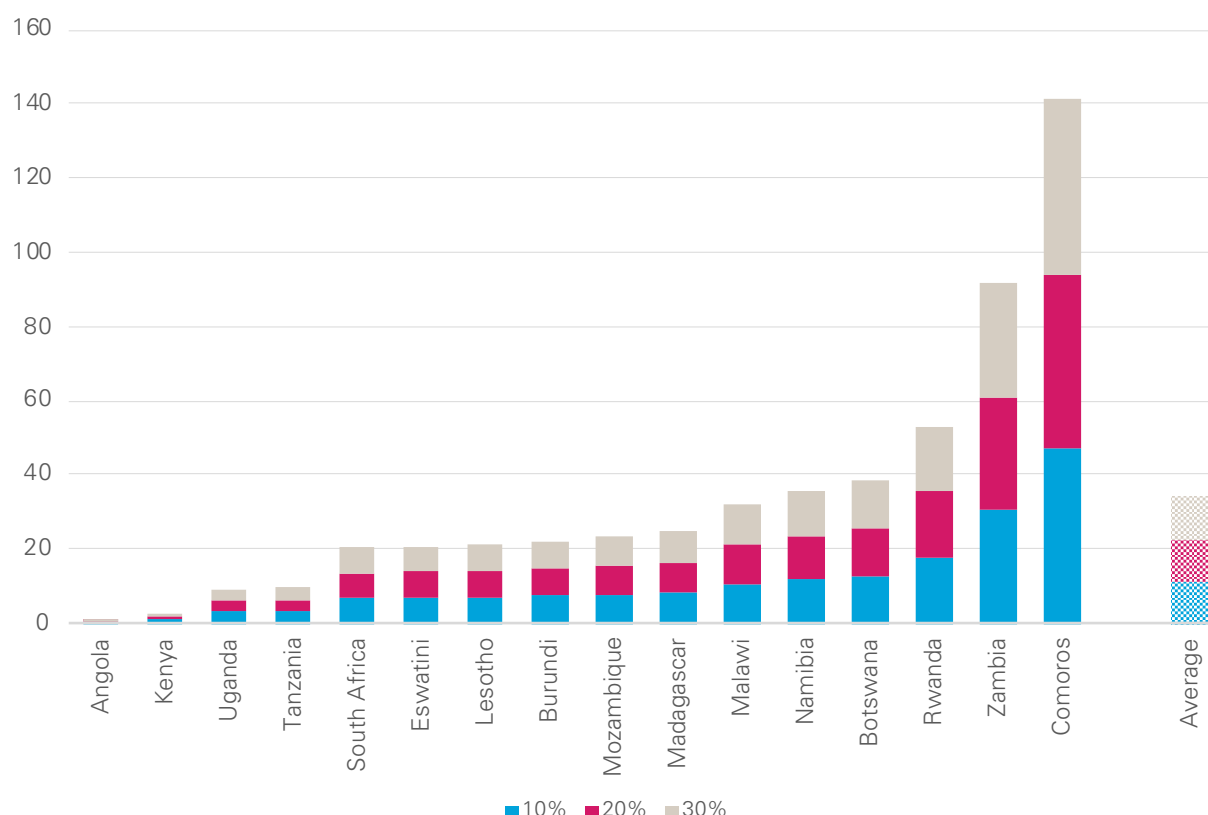
Source: IMF World Economic Outlook Database (October 2018).

Figure 2.30. IFFs, 2011-13 period averages (in millions of current USD and as % of GDP)



Source: IMF World Economic Outlook Database (October 2018).

Figure 2.31. Potential additional impact of recapturing half of estimated IFFs on health expenditure (as % increase on health budget based on the application of different tax rates: 10%, 20% and 30%)



Sources: Author's calculations based on IFF data from Global Financial Integrity (2017), health expenditure data from WHO Global Health Expenditure Database and GDP data from IMF World Economic Outlook Database (October 2018).
 Note: Assumes a recapture rate of 50 per cent of the average IFF estimates during 2011-13 (the latest available years) and presents the application of different tax rates to the recaptured funds.

cash movements. In addition to enabling organized crime, facilitating corruption and undermining governance, IFFs hinder development objectives by limiting tax revenues, including customs duties, income taxes and VAT.⁴² Looking at the latest available three-year period averages (2011-13), IFFs amounted to around US\$33 billion or 7.6 per cent of GDP per year when combining the group of 16 countries (Figure 2.29). Notably, these were almost exclusively the result of trade mispricing, with capital flight (also known as “hot money”) accounting for only around 4 per cent of total outflows, on average.

Capturing even a portion of IFFs could significantly bolster human capital investment in many contexts. The latest three-year estimates indicate that the average annual outflow of IFFs was between 6 and 9 per cent of GDP in four of the countries studied (Eswatini, Madagascar, Mozambique and the United Republic of Tanzania), between 10 and 15 per cent of GDP in five of the countries (Botswana, Malawi, Namibia, Rwanda and Zambia) and around 20 per cent of GDP in South Africa (Figure 2.30). As an illustration, if governments were able to prevent or recapture 50 per cent of the IFFs in a given fiscal year, effectively tax those resources by 10 per cent and then direct all the new revenue to the health sector, public investment in health would increase by 11 per cent on average

42 Global Financial Integrity (2015). *Illicit Financial Flows to and from Developing Countries: 2004-2013*. Washington, DC.

across the sample or by as much as 20 per cent in Rwanda, 30 per cent in Zambia and 50 per cent in Comoros (Figure 2.31: blue bars). If those recaptured resources were alternatively taxed at a higher rate, such as 30 per cent, health sector investment could jump by more than 33 per cent across the sample or climb by more than 90 per cent in Zambia and 140 per cent in Comoros (Figure 2.31: grey bars).

Data constraints prevented the development of country scenarios to estimate the impact of different policy responses on IFFs and funding human capital investment. Nonetheless, most of the reports discussed trends and potential approaches, noting that there are many things that governments can do to prevent and recapture IFFs. This includes a variety of actions to strengthen customs controls, procurement processes, and tax collection and enforcement capacity. Detailed policy approaches have been described in a variety of recent reports, from organizations including Global Financial Integrity,⁴³ the United Nations Economic Commission for Africa (UNECA)⁴⁴ and the World Bank.⁴⁵ At the same time, the World Bank and the United Nations Office on Drugs and Crime partnered to create the Stolen Asset Recovery Initiative, which provides support to end safe havens for corrupt funds and facilitate more systematic and timely return of stolen assets.⁴⁶

2.7 Regional and country perspectives on fiscal space in ESAR

At the regional level, the starting point is to recognize that the human capital investment outlook is slightly negative, on average, but with very mixed performance. Returning to the baseline projections of the evolution of human capital investment shown earlier in Section 2.4.4, real per child expenditure was predicted to slightly decline over a five-year period across the 16 countries, on average. However, the forecasts were diverse, with five countries declining steeply (more than 10 per cent), three countries contracting minimally (between 2 and 5 per cent), two countries experiencing very modest increases (around 2.5 per cent), and six countries undergoing larger increases (20 per cent or more). Irrespective of the projected trajectory, developing the human capital base is a priority for all governments, which means that maximum efforts should be devoted to increasing expenditure in these areas.

But what are the most promising options from a regional perspective? One possible approach to addressing this question is to look at the regional averages for the alternative scenarios that were modelled. However, several important caveats must be noted. First, the different adjustments made to each macro-fiscal programming model and assumptions made remain fully valid, as described in Annex 2. Second, only 38 of the 87 alternative scenarios that were included in the 16 studies were analysed in Section 2.5, which means that the data offer an imperfect picture of the potential fiscal space that could be created (or not). Lastly, the regional averages mask stark differences and opportunities at the country level.

Bearing these methodological issues in mind, reprioritizing the budget appears to be one of the best opportunities to raise expenditure on human capital in the region. The nine countries that included this as an alternative scenario found it having the largest potential returns. On average, progressively reallocating resources away from non-priority areas

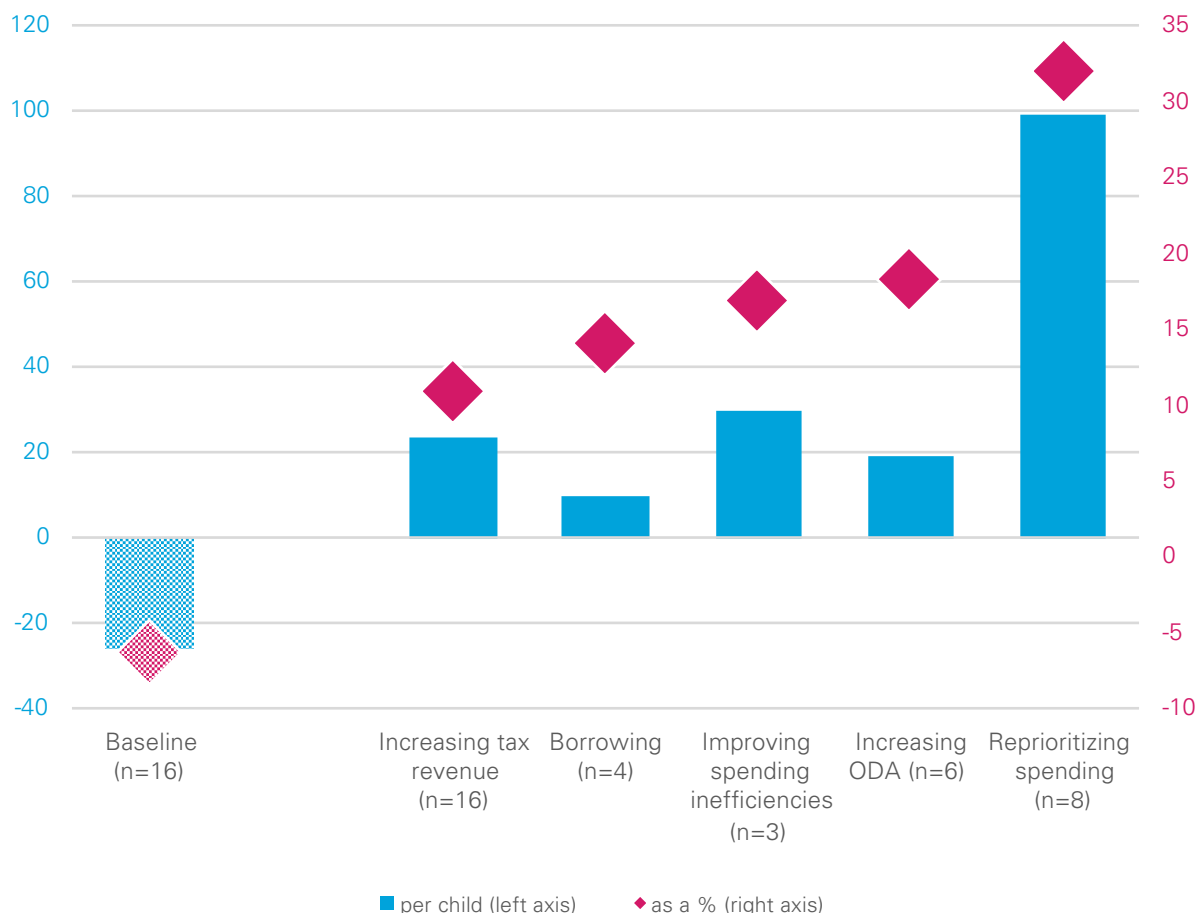
43 Ibid.

44 United Nations Economic Commission for Africa (UNECA) (2017). *Impact of Illicit Financial Flows on Domestic Resource Mobilization: Optimizing Revenues from the Mineral Sector in Africa*. Addis Ababa: UNECA, African Union and African Minerals Development Centre.

45 Reuter, P. (2012). *Draining Development? Controlling Flows of Illicit Funds from Developing Countries*. Washington, DC: World Bank.

46 See: <https://star.worldbank.org/>.

Figure 2.32. Potential additional impact of five alternative scenarios to increase human capital investments after a five-year projection period compared to the baseline scenario (in per child constant US\$ and as %)



Sources: See Figures 2.12, 2.15, 2.18, 2.22 and 2.28 as well Annex 2 for a description of the methodology.

Notes: Human capital investments are defined as those in education, health and social protection; the child population is all persons 0-17; the base year for constant US\$ and exchange rates varies across the sample.

to human capital sectors could potentially increase real per child expenditure by an average of around 30 per cent above the baseline scenarios (Figure 2.32). While this approach requires strong political will, all governments should have some flexibility to alter their budget priorities, even if starting with small changes. This should make budget reprioritization the most likely prospect in the region.

Revenue is another very promising channel to increase human capital investment in the region. While most countries were expected to benefit from natural revenue growth over the projection periods, the impact of larger budgets will likely be minimized by rising prices and population sizes. However, adjusting existing rates, introducing new taxes and/or strengthening collection and enforcement capacity can help all governments extract more revenue from their economies to support greater expenditure on human capital. The potential opportunity was demonstrated by the fact that half of the governments studied were recently extracting a level of taxes equivalent to less than 15 per cent of the size of their economies, which is very low by global standards. VAT was looked at almost universally in the country studies, with many also focusing on CIT and PIT, as well as innovative tax measures. When taken together, the different approaches modelled in all

the countries showed the possibility of increasing real per child expenditure 10 per cent higher than the baseline scenarios, on average (Figure 2.32). While the political scope for tax increases will be limited in contexts of fiscal tightening or slow growth, improved administration is likely to be more generally accepted and is a strong fiscal space option for the region.

Addressing spending inefficiencies would be another very good way to boost actual investment in human capital sectors across the region. While data constraints impeded the development of modelling scenarios in most countries, the projected results from three countries were promising. There, progressively enhancing budget execution rates in one or more human capital sectors was forecast to increase real per child expenditure by an average of nearly 20 per cent above the baseline scenarios after five years (Figure 2.32). The rapid review of the recent performance of budget credibility rates from various sources also confirmed the magnitude of the problem facing most countries, especially for capital items, and further underscored the unexploited potential of this approach to enhance fiscal space.

The other options for supporting greater expenditure on human capital sectors were either confined to a subset of countries in the region or require further investigation. This includes ODA, borrowing, fiscal savings and IFFs, which are briefly discussed below.

On the ODA front, the near-term projections suggest that increasing the volumes of grants and concessional loans could benefit some countries. Recent beneficiaries of large ODA flows, especially LICs, could make a compelling case for increased support given the existing human capital deficits. Of the six countries that included this alternative modelling scenario, projections suggested that advocacy to attract more foreign assistance could boost real per child expenditure by an average of close to 20 per cent above the baseline scenarios after five years (Figure 2.32).

Similarly, the rapid accumulation of debt in recent years indicates that borrowing will not be a primary prospect for the region. The growth of domestic debt acts as a major bottleneck, as short maturities and high interest rates mean that repayments are already pressuring many national budgets. And while the updated global thresholds indicate that there may be some space for greater external debt stocks, lack of creditworthiness coupled with high existing obligations limit this potential, particularly when considering that investment in human capital sectors only generates economic returns over long horizons – and far beyond short-term repayment periods. Nonetheless, four country studies did look at this option, demonstrating the possibility of increasing real per child expenditure by an average of more than 10 per cent above the baseline scenarios according to different arrangements (Figure 2.32). Another six countries are expected to have relatively manageable debt loads over the near term (e.g. below 40 per cent of GDP), which could suggest at least the possibility for further exploration of this avenue.

Turning to fiscal savings, this could be a viable option in the distant future for the group of countries that are expected to become significant exporters of natural resources. However, questions surrounding the timelines for and management of future revenues remain too great at present for this to be a realistic near-term consideration. This option was not modelled in the country studies, but the use of resources stored in sovereign wealth funds can certainly be evaluated in Angola and Botswana.

Lastly, IFFs are one of the most exciting potential pathways to produce fiscal space in the region, but more information is needed. The estimated magnitude of illicit resources is distressing in most countries, and the simple illustrations used to demonstrate how the prevention or capturing of these funds could positively impact human capital budgets was hopeful. Regrettably, the lack of reliable data at the country level was too great

to allow for a modelling attempt: this also stands as a barrier to better understanding and addressing the underlying factors that enable IFFs to flourish. Nonetheless, IFFs are clearly an area of research that should be at the fore of government and DP agendas.

Turning to each of the 16 countries studied, what can be said about the most feasible fiscal space options over the near term? One perspective can be obtained by analysing information from global databases alongside the results of the alternative scenarios from the adjusted macro-fiscal programming models (as presented in Section 2.5). In other words, assessing performance against a general set of key indicators can offer an initial indication of country-level potential to pursue different fiscal space strategies. The methodology used to carry out this rapid classification is described in Annex 3, which included looking at the average annual projected changes over the 2019-21 period for some indicators and the latest available levels for others, and then rating them against objective criteria (to the degree possible).

The country-by-country results are summarized on the following pages. Table 2.01 uses a colour coding scheme that indicates the likely potential of each country to increase fiscal space for greater investment in human capital across 14 different indicators. To better contextualize the likely position of each country, the first column presents the natural fiscal space outlook for human capital, reflecting the real per child expenditure projections from the baseline modelling scenarios presented in Section 2.4.4. Building on that information, Table 2.02 attempts to provide an aggregated view across the seven fiscal space categories reviewed in the report.

The key takeaway from this rapid classification approach is that every country has at least one very strong potential option to boost investment in human capital over the near term. With five high-potential categories identified, Botswana emerges as the country with the largest number of opportunities that could be explored. Malawi, Rwanda, Uganda and the United Republic of Tanzania were each found to have four high-potential categories available for further investigation, with three each in Angola, Kenya, Lesotho, Namibia and Zambia. Reprioritization emerges as the category providing the biggest opportunity across the sample (identified as high potential in 13 countries), followed by revenue, ODA and IFFs (in eight countries each).

The other important takeaway is that countries can simultaneously pursue a variety of fiscal space strategies. This could involve looking across multiple categories (e.g. reprioritization, the efficiency of spending and ODA) or across multiple options within a single category (e.g. introducing a new tax – for example on property, increasing the tax rates applied to luxury goods by a certain percentage, and strengthening efforts to improve tax administration capacity). Ultimately the generation of small amounts of fiscal space from different sources can quickly add up and significantly alter the human capital investment trajectory in each country.

Table 2.01. Country profiles: Rapid assessment of fiscal space potential by select indicators, 2019-21 (or latest available) (in projected average annual changes or latest available levels – see Annex 3 for description of rating methodology)

Category	Revenue			ODA		Reprioritization		Spending efficiency		Borrowing		Fiscal savings	IFFs
Source	country model	IMF	IMF	country model	OECD	country model	SIPRI, WHO	country model	country model	IMF	IMF	Sovereign Wealth Fund Institute	Global Financial Integrity
Indicator type	projected annual change	projected annual change	Level	projected annual change	projected annual change	projected annual change	level	projected annual change	level	level	projected annual change	yes/no	level
Indicator	real per child expenditure above baseline (%)	real per capita revenue (%)	tax revenue, latest (% of GDP)	real per child expenditure above baseline (%)	real per capita ODA (%)	real per child expenditure above baseline (%)	military-to-health ratio, latest (%)	real per child expenditure above baseline (%)	education and health budget credibility rates, latest (%)	level of debt distress, latest	gross debt, 2019 (% of GDP)	sovereign wealth fund established	IFFs, latest (% of GDP)
Angola	18.2	0.6	10.3	2.0	-5.1	12.9	1.03		1.13		71.8	yes	0.5
Botswana	-0.4	1.4	20.8		18.0	1.1	0.52				13.5	yes	12.3
Burundi	-2.7	-3.0	12.2	4.9	-8.0		0.32	2.4	0.97	high	63.5		1.4
Comoros	5.2	0.1		1.7	-1.1	7.9	1.15		0.96	high	30.5		0.1
Eswatini	-2.7	-0.3	28.6		40.1	4.2	0.17	0.7			44.3		7.2
Kenya	13.7	3.0	15.8		-2.4		0.17	4.3	0.81	moderate	55.4		1.7
Lesotho	-2.3	3.2	36.4		37.0	0.9	0.15		0.74	low	38.7		3.7
Madagascar	3.8	0.6	11.4		3.6		0.14		0.77	moderate	36.4		5.7
Malawi	0.7	2.4	17.3	1.6	27.4	2.6	0.08		0.89	moderate	57.6		11.9
Mozambique	-0.6	-0.3	20.1	6.8	-5.0		0.14		0.89	distress	118.7		9.1
Namibia	-5.5	1.3	28.5		16.4	0.8	0.32		1.04		54.0		14.0
Rwanda	7.2	3.2	14.8		8.3	20.7	0.26		0.89	low	43.4		10.1
South Africa	-3.7	0.9	27.1		-11.5		0.11		0.99		57.3		19.8
Tanzania	11.4	5.7	11.9		-2.8		0.24		0.66	low	38.6		9.1
Uganda	0.7	4.6	13.5		7.5		0.39		0.73	low	44.7		4.4
Zambia	-0.9	-0.5	14.9		10.8		0.23		0.95	high	77.6		15.1

Note: This rapid categorization is only intended to be illustrative and to facilitate an initial dialogue of fiscal space opportunities that could be explored at the country level, including through the collection and analysis of the latest available information.

Legend		
Low	Medium	High
		NA

Table 2.02. Country profiles: Rapid assessment of fiscal space potential by categories over 2019-21 period
(see Annex 3 for description of rating methodology)

	Outlook	Revenue	ODA	Reprioritization	Spending efficiency	Borrowing	Fiscal savings	IFFs	Categorical Potential		
									High	Medium	Low
Angola									3	1	3
Botswana									5	1	0
Burundi									1	3	2
Comoros									2	2	2
Eswatini									2	4	0
Kenya									3	0	3
Lesotho									3	3	0
Madagascar									2	4	0
Malawi									4	2	0
Mozambique									1	4	1
Namibia									3	1	2
Rwanda									4	2	0
South Africa									1	2	3
Tanzania									4	1	1
Uganda									4	2	0
Zambia									3	1	2

Note: This rapid categorization is only intended to be illustrative and to facilitate an initial dialogue of fiscal space opportunities that could be explored at the country level, including through the collection and analysis of the latest available information.

Legend		
Low	Medium	High
		NA

CHAPTER 3.

THE POLITICAL ECONOMY OF BUDGETS IN ESAR

Having identified opportunities for governments to create fiscal space to further develop their human capital base, the report now tries to understand how to carry such messages forward and ultimately influence investment decisions. To do so, it presents the main findings from the 16 political economy analyses that complemented the fiscal space studies. It starts by providing a short overview of how the assessments were carried out at country level. It then offers a regional picture of budget processes, including political and economic factors as well as dynamics and actors that influence decision-making processes. Following the descriptive analysis, the chapter presents specific entry points that UNICEF and partners can explore when advocating for more and better expenditure on human capital, which cut across the budget cycle as well as the budget transparency and accountability agenda.

3.1 Background to the country studies

The political economy analyses sought to uncover the various incentives that underpin decisions in each country's budget cycle. The research identified the key stakeholders in the budget process and the motivations that inform them in terms of prioritizing, planning and allocating budgets to line ministries, specialized agencies and/or sub-national authorities. The studies focused on the sectors that are most relevant for children's welfare and human capital, and ultimately identified entry points and strategies that could be adopted by UNICEF to more effectively influence PFM processes.

The analyses drew on information from state and non-state actors that are involved in or contribute to policy-making and budgeting in the area of human capital. Secondary data included documents and publications from governments, UNICEF, DPs and civil society organizations (CSOs), as well as global data sources. Primary data was mainly collected through face-to-face interviews and email exchanges. At the country level, meetings were held with key stakeholders in government ministries, international financial institutions (IFIs), DPs and CSOs.

As in the fiscal space studies, the political economy work was also conducted in three phases. During the first phase, which was desk-based, relevant documentation was collected, discussions were held with the respective UNICEF country offices, and field work preparations were made. The second phase consisted of a field mission to interview key stakeholders, which normally lasted seven working days. The missions were led by a consultant from Ecorys or DNA Economics, with the assistance of a local consultant. The third phase was preparing a final report that brought together the key findings and conclusions.

The analytical reports were divided into four chapters. The first chapter addressed the broader political context of the country and presented key political factors that affect the level and allocation of resources. The second chapter analysed current government strategies and reflected on the priorities given to human capital issues. The third chapter focused on the budget process itself, describing the institutional and legal budgeting framework, as well as the key actors and their levels of influence. The final chapter presented strategic entry points for UNICEF to advocate for more and better investment in children.

The inherent complexities of conducting a political economy analysis presented challenges in some contexts. In particular, understanding and receiving authentic insights into the motivations of institutions and specific actors was not always straightforward. Access, time, and perceived credibility and trust were among the factors that had to be overcome in order for certain truths to surface. As such, the depth and quality of the assessments, which were conducted in relatively short timeframes, generally varied according to the availability of interviewees and their information. In some cases, these challenges made it difficult to develop concrete suggestions for UNICEF.

3.2 The political economy context of the budget

The “economic growth” narrative dominates development discourse and investment decisions in ESAR. Many of the countries studied have focused their national development strategies (e.g. long-term visions and medium-term implementation plans) on increasing growth in order to achieve higher income status. This has directly influenced budget discussions, as authorities place more emphasis on the economic returns of their investments. As a result, one of the key challenges for UNICEF and other partners in advocating for more child-focused expenditure is to convince decision makers that such spending is, in fact, a *long-term investment* – developing the human capital and hence economic potential of the country – rather than a *short-term cost*.

The structure of the economy and the level of growth are also important influencers. Some countries, such as Kenya and the United Republic of Tanzania, discovered natural resources relatively recently, which contributes to a generally positive economic outlook and a sense of optimism for the long term. In contrast places like Angola and Botswana, which have depended on oil and diamonds respectively for decades, face a sense of urgency to undergo structural reforms to increase the competitiveness of non-resource sectors of the economy and ensure that growth can be sustained as natural resources are depleted. In other countries, like South Africa and, in turn, Eswatini, Lesotho and Namibia, weakening global trade conditions have hampered economic growth and hence revenues. This has resulted in intensifying fiscal austerity, which presents a worrisome outlook for human capital expenditure.

Beyond the economy, low budgetary transparency and accountability have direct impacts on budgeting processes in the region. Rent-seeking and patronage are everyday realities in some environments: these hinder efficient and effective spending across the board. This can involve the disappearance of resources, personal gain as a driving force behind budget allocations, and the suspension of ODA as DPs suspend support due to corruption and impunity. To illustrate the latter, ODA declines were triggered by the discovery of massive amounts of undisclosed loans in Mozambique and the looting of public funds during the “Cashgate” scandal in Malawi. In short, the absence of effective governance measures to identify and prevent the abuse of public power continues to directly affect budget processes and the availability of resources for human capital sectors.

At the same time, DPs are exerting less influence over policy and budgeting processes. There are various reasons behind this. First, sustained, high economic growth has led to less dependence on aid, along with an increased sense of autonomy and national pride, such as in Rwanda and Zambia. Second, new, non-traditional actors, including China, have emerged to offer alternative sources of financing without conditionalities, which has reduced the influence of DPs in places like Angola and Kenya. Third, the change in aid modalities, marked by a move away from general budget support toward sector support, has caused policy dialogue to shift from the national level to sector levels, which characterizes most LICs. Fourth, many countries studied are facing temporary suspension or sudden declines in aid because of political crisis (e.g. Burundi) or fraud allegations (e.g. Malawi and Mozambique).

Executive branches remain powerful and shape development and investment decisions in most ESAR countries. In Angola, Rwanda and the United Republic of Tanzania, for example, presidential will drives the development process. While anti-corruption and anti-patronage stances are praiseworthy, critics point to the risks of creating cultures of fear and limiting democratic processes. In other countries, excessive use of executive power has led to crises, such as in Burundi where a political crisis broke out when the president ran for a third term. In Eswatini, where the King concentrates power and political parties are banned, the executive stalls progress. Hence, the executive branch, whether supporting a development agenda or not, is a key influencer in policy and budget allocation processes.

Political instability is another important regional factor that affects the design of budgets. In Lesotho, three elections were recently held over a five-year period, demonstrating the inherent instability of coalition governments, which are easily dismantled by political infighting and no-confidence motions. Madagascar has witnessed regular political crises that generated periods of harsh economic recession. Since the end of the last major political crisis in 2013, the country has begun to recover, but politics continues to disrupt. The November 2018 election was bitterly contested, including by former presidents, and only decided after a run-off and the eventual intervention by the High Constitutional Court. Although political instability can sometimes lead to a shift in government which, in turn, can turn out to be positive for investment in social sectors, unstable politics are generally bad for growth and advocacy efforts.

Political parties, which tend to lack ideological foundations, are additional forces over budget processes in many countries. In general, voter preferences and political dynamics are not founded on ideologies, but rather on other dimensions, such as ethnic backgrounds or regional affiliations. This is clearly the case in countries like Kenya and Malawi. The policies of political parties and members of parliament (MPs) also tend to be driven by individual and clientelistic goals. In such contexts, using party ideology for advocacy purposes is a dead end. Furthermore, various ESAR countries face strong political polarization, which often contributes to high levels of patronage. Patronage, in turn, is generally not supportive of policy-based allocation processes, such as evidenced in Comoros.

Lastly, decentralization and local politics are increasingly important influencers of budget processes in the region. Kenya is the most extreme example: the rapid devolution process has given 47 counties a large degree of independence from the national government. In most countries, however, decentralization mainly concerns the downward delegation of service delivery, while decision-making and budget-making powers remain at the central level. Despite the move toward decentralization, local governments remain heavily dependent on central governments for funding via transfers. And while most countries show strong interest in increasing local revenue generation capacity and achieving greater autonomy, local empowerment remains undermined by political tensions and the unofficial desire of key stakeholders to keep power centralized.

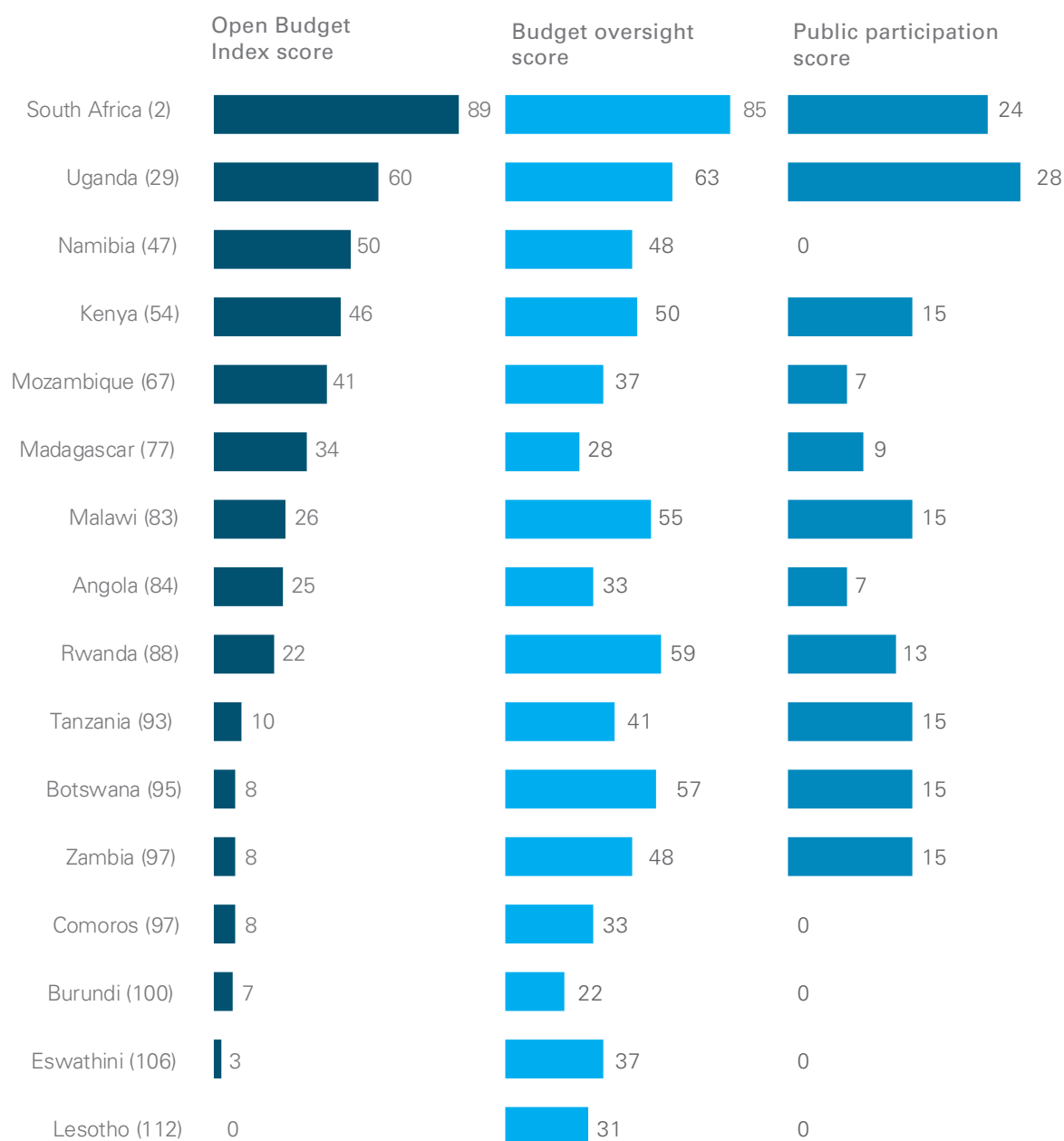
3.3 Key dynamics and actors in budget processes

3.3.1. Budgeting dynamics

ESAR is marked by varying degrees of transparency, oversight and participation in budget processes. For example, on one side of the spectrum, South Africa touts the highest Open Budget Index score in the world, providing its citizens with “extensive” information (Figure 3.01). On the other side of the spectrum, Lesotho has the lowest score in the world, which indicates that it provides no budget information in the public domain. The degree of budget openness in a country directly affects the ability of UNICEF and DPs to influence budget

Figure 3.01. Open Budget Index scores in the 16 political economy countries, 2017

**Country
rank (115)**



Source: International Budget Partnership (IBP) (2017). Open Budget Survey 2017. Washington, DC.

processes and hence advocacy strategies to increase child-focused expenditure. In very open contexts, UNICEF can use budget data and participation mechanisms to move the human capital agenda forward. Closed contexts, in contrast, require a stronger focus on making budget processes more open.

Although most countries have implemented PFM reforms to establish a structured framework around budgeting processes, compliance continues to present challenges. For example, in Kenya, Malawi, Rwanda, South Africa, Uganda and the United Republic of Tanzania, sound legislative frameworks are in place. The laws, however, are not always followed. In Malawi and Uganda, the budget process offers many opportunities for consultations and inputs from various stakeholders, but in practice the processes are rituals rather than genuine forums for dialogue. Other examples of non-compliance are expenditure ceilings that are altered after formal deadlines (e.g. Kenya) or where budget calendars are not adhered to (e.g. Malawi). Nonetheless, the existence of comprehensive legislation is important for advocacy efforts. As noted by a recent World Bank study on the political economy of PFM reforms, although laws are not consistently applied, “improved PFM rules are an important foundation for seeking better *de facto* management of public resources.”⁴⁷

In some cases, the legislative framework itself would benefit from changes. For instance, in Eswatini, the entire process is very secretive. And in Angola, there are no official channels for participation, while large extra-budgetary expenditure, unrealistic budget figures and the lack of comprehensive budget classification make it impossible to decipher the real expenditure of different ministries. Lack of budget credibility and weaknesses in budget execution and reporting also complicate the participation of outside actors in the budget process, which was particularly acute in Comoros.

3.3.2. Budgeting actors

The executive leads budgeting processes through the MoF. In all countries, the MoF sets the rules and supervises budget preparation. Moreover, the MoF leads discussions with line ministries and puts together a comprehensive budget proposal, which is approved by cabinet before going to parliament for review.

In most countries the presidency wields large influence over the budget. Here, the presidency interferes with the MoF’s mandate and the budget process, which can include changing budget ceilings after deadlines have passed or reallocating funds without justification. In places like Kenya and Rwanda, presidential pledges have the highest priority and can lead to significant budget reallocations in the final stages of budget preparation or even during budget execution.

In other countries, the MoF can push its own agenda. In Madagascar, for example, the MoF is powerful partly because of strong engagement of the IMF, which provides it with technical capacity. In Angola, the MoF’s authority stems from the highly centralized decision-making structure of the political system as well as the relative weakness of other parts of the administrative system. In Lesotho, political instability has allowed the MoF to dominate the budget planning stage.

Conversely, the position of line ministries tends to be weakened by the dominance of the presidency and the MoF. While some degree of top-down budgeting is required, in most countries the power of the presidency and/or the MoF leaves little room for line ministries to exert influence. In countries where the MoF and/or presidency do not comply with the

⁴⁷ World Bank (2017). *Political Economy of Public Financial Management Reforms*. Washington, DC.

budget calendar, line ministries are left to adjust their planning and budgets according to central-level decisions. In a number of countries, it was reported that lack of regard for sector budgeting hurt social sectors. Human capital-related spending, such as for child protection or nutrition, are easily scratched off during budget preparation. The situation in Lesotho is different from most other countries in this regard. There, political instability enables line ministries to “play the system” by omitting priority programmes from their budget because they know that the MoF will reintroduce them later.

The limited capacity of line ministries further diminishes their influence even if they have opportunities to engage in budget dialogue. In many countries, problems were encountered in planning and budgeting at the sector level. Medium-term sector strategies were not elaborated, and when they existed they were not costed or largely written by consultants. Lack of financial knowledge affects the quality of budget proposals and gives ample room for the MoF to simply overrule the line ministries or to set priorities on their behalf. Furthermore, the lack of knowledge on costing and budgeting negatively impacts intra-sectoral budgets and plans. In South Africa, for example, the Department of Basic Education faces a situation in which personnel expenditure crowds out all forms of non-discretionary expenditure.

In decentralized contexts, the main budget decisions are still taken at the central level. Local governments are usually given responsibility for service delivery. While they are granted certain autonomy in how to organize this, they remain financially dependent on the central government. Some form of bottom-up input is usually provided during the budget formulation process, but local priorities are not always translated to the central level. This could result from the central government successfully defending its own interests over those of the local government and/or low levels of local government capacity to set budget priorities. Lack of representation can also be problematic for social sectors.

The role of DPs in budget processes has been mostly confined to the sector level. Previously, DPs were often represented in budget support working groups. As general budget support conditions touched upon inter-sectoral issues, the dialogue took place partly at the central level. However, with the decline in general budget support, sector working groups are now the main platforms for DPs to interface with the budget design process.

On the civil society front, their ability to engage and influence budget processes varies widely. In some countries, CSOs are part of budget discussions and able to exert some influence over allocative decisions. Elsewhere, CSOs are provided a platform in budget dialogue, but this is more of a ritual. For example, in Malawi and Uganda, CSOs are consulted at various stages of the budget process, but there is limited scope to express views, feedback is not formalized and ideas are not actually debated. In places like Angola and Comoros, there are no spaces for CSOs to contribute to budgetary processes.

Similar to civil society, parliaments often lack the capacity and opportunities to influence budget processes. Most countries have introduced sophisticated budgetary oversight and external control frameworks to guide the budget process, especially approval and execution. Yet few MPs make meaningful changes, for various reasons. In some countries, MPs are driven by individual or clientelistic motivations, and rent-seeking and patronage block effective oversight. In other countries, MPs simply do not have the technical knowledge. Elsewhere, engagement is limited due to the parliament’s lack of independence from the executive branch. An independent parliamentary budget office has played a positive role in supporting the parliament’s budget oversight function in some countries. In Kenya, for example, this technical arm has a wealth of expertise, although MPs are not always interested in accessing this.

Audit offices and other control bodies face similar capacity challenges. This means that

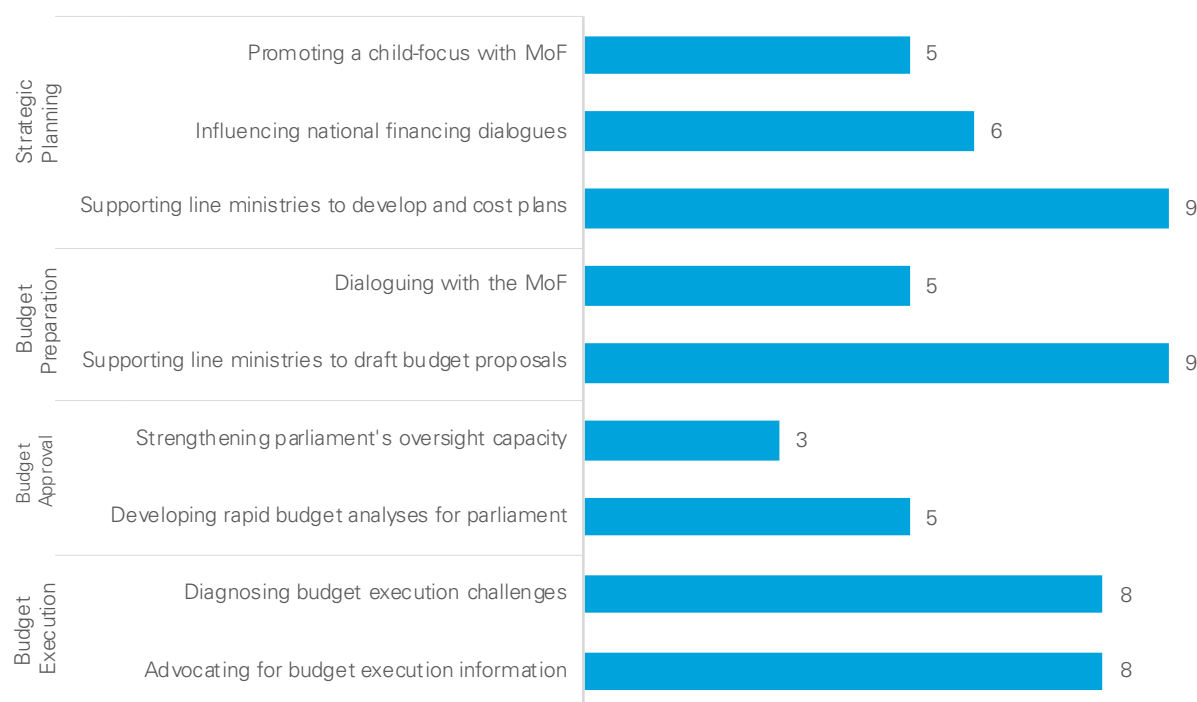
following up on their findings depends on the executive branch and parliament. And even where actions are taken, ambition is usually quite limited. The culture of impunity, which is pervasive in some countries, can also greatly hinder the effective functioning of these institutions.

3.4 Advocacy entry points

Each of the 16 countries studied has a unique set of entry points to make the case for increased investment in human capital. This is partly explained by the distinct political economy environments across countries, but also by differences in PFM frameworks and practices. Another important factor is the capacity, experience and relationships of each UNICEF country office. Whereas some offices have designated staff working exclusively on PFM issues, others do not. At the same time, some offices have been engaging the government on PFM issues for more than five years, having jointly conducted multiple studies and other initiatives, and hence have developed close ties with influential decision makers. In contrast, other offices are new to the field and have much better contacts with social sector line ministries than with MoF officials or the parliament.

The 16 political economy studies demonstrate that there is a range of strategic opportunities for UNICEF to influence the budget cycle. When looking at the strategic planning phase, supporting line ministries to develop and cost strategies and plans was identified as the single biggest opportunity, followed by contributing to financing discussions and direct advocacy with the MoF (Figure 3.02). In the budget preparation phase, most country offices could exert significant influence by providing technical support to line ministries to develop their annual budgets, while also dialoguing with the MoF. At the approval phase, many offices have opportunities to work with parliament, both to share recommendations

Figure 3.02. Main advocacy entry points identified in the budget cycle in the 16 political economy countries (in # of countries)



on how the draft budget can be more responsive to children's needs as well as to provide training to strengthen oversight functions. Lastly, during budget implementation, UNICEF country offices can identify and help to remove budget execution spending bottlenecks, especially at subnational levels, and also advocate for the MoF to generate and report on budget execution information. These opportunities are discussed below.

3.4.1. Strategic planning

Access and influence national financing dialogues

Space for external actors to influence policy dialogue has been shrinking in many ESAR countries in recent years, which poses a challenge to UNICEF's advocacy efforts. As earlier discussed, this is partly due to the shift in aid modalities. At the same time, most governments in the region aspire to be more autonomous in policy and strategic priority setting. In practice, this has made it increasingly difficult for many UNICEF offices to meaningfully affect policy discourse in favour of child-friendly sectors at both strategic and technical levels.

In some countries, there may still be a direct entry point to take part in discussions on budget allocations at national level. UNICEF should monitor such openings and capitalize where possible. For instance, in Madagascar and Malawi, elections create a level playing field where a new government may come in and be looking for assistance in policy making. This is also a potential opportunity to become involved in drafting new or updated National Development Strategies/Plans.

In other contexts, where spaces are more confined, partnerships with line ministries, CSOs or think tanks may allow for indirect advocacy at national level. When searching for strategic partnerships, UNICEF offices should consider both the existence of shared mandates and objectives and the actual impact of influence in formal budget decision-making processes. In most countries, access to the cabinet and/or the presidency was viewed as difficult, but in some situations UNICEF succeeded in gaining access at that level, sometimes through informal channels.

In policy dialogue, UNICEF should build its advocacy argument on its expertise in child-related matters. Partners tend to listen to UNICEF because staff have expertise on children's issues and human capital – not because they are PFM experts. However, it is important that offices attempt to better link child-friendly expenditure with economic growth agendas, where applicable. This implies that UNICEF offices should take better advantage of advocacy-based PFM tools in the region, especially investment cases (e.g. cost-benefit analysis, cost of inaction analysis and economic return on investment analysis). PFM-based investment cases are likely to make governments more receptive to advocacy efforts toward child-friendly expenditure.

The country studies also shed light on emerging topics that UNICEF could use to better position itself to influence policy dialogue and financing discussions. These include the population boom, social protection and the economic growth agenda, which are briefly discussed below.

One big entry point is around the demographic dividend. Human capital expenditure is seen as having potential to harness the growth linked to the ongoing demographic transition that is taking place in most countries. Both the IMF and World Bank are paying more attention to population dynamics, calling for strengthening human capital to deliver greater and more inclusive growth. In addition to ensuring quality access to basic social services as the foundation for reaping demographic dividends, other key programmatic

issues include providing practical skills to the current and future labour force (e.g. through vocational education and job training programmes) and empowering women (e.g. by improving fertility choices and addressing cultural issues).

A second and related entry point is social protection. UNICEF has already made strong progress on this issue in many countries. The broader literature, as well as the growing body of experiences in the region, especially through the Transfer Project, is very compelling about the positive impacts of different social protection interventions on economic growth and poverty reduction. Most offices are well positioned to continue to build on this momentum, both by piloting approaches where social protection systems are non-existent or very limited, and by scaling interventions and linking to the cash plus agenda – connecting transfers to additional services, like early childhood development (ECD), nutrition and WASH. At the same time, weather forecasts indicate that countries in Southern Africa and the Horn of Africa could be hit by the forces of El Niño during 2019. Cyclone Idai, which reaped devastation across Malawi, Mozambique and Zimbabwe in March 2019, was a humbling reminder of natural threats and the urgent need to strengthen social protection systems and their shock-responsiveness.

Linking children to the infrastructure and investment agendas is another potential entry point. This starts by recognizing that support for infrastructure can be beneficial to children. This includes both direct benefits (access to electricity can increase their study time, new or improved water and sanitation systems can improve their health and reduce their time spent doing household chores like fetching water, better roads can make it easier for them to reach schools and health facilities and hence improve learning and health outcomes, and so on), as well as indirect benefits (e.g. public works programmes, irrigation systems and access to electricity can create job opportunities for their parents and contribute to improved living standards). In parallel, now that most governments in the region have invested heavily to address physical infrastructure gaps, there may be opportunities to shape dialogue around national investment plans toward supporting access to social services and hence closing human capital investment gaps.

Promote a child focus in policy making and budgeting processes with the MoF

Many of the country studies argued that UNICEF needs to take better advantage of nurturing close partnership with the guardian of the budget: the MoF. Here, one potential entry point is around the development of annual budget guidelines, in particular in countries where UNICEF has a strong PFM profile and close working relations with the MoF. More specifically, UNICEF could engage in technical dialogue around budget preparation to encourage the reflection of children's deprivations and needs in the budget. Another possible entry point is for UNICEF offices to follow up with the MoF early in the budget cycle to discuss how child-related priorities are incorporated into the budget framework paper (or the equivalent).

Support line ministries to develop and cost strategies and plans

In many countries, sector strategies and plans either do not exist or are not meaningful. In practice, this means that they are either not costed or not considered during budget planning. However, strong sector plans can lead to more realistic and policy-based budgeting since they provide a framework for prioritizing resources each year. At the same time, good sector plans can also serve as advocacy ammunition for line ministries (and UNICEF), as they contain evidence that can be used to help convince the MoF and other influential decision makers of the importance of investing in social sectors.

UNICEF should consider increasing efforts to support line ministries as they formulate sector strategies and plans. Here it is imperative that strategy and planning documents

rely on a well-developed logical framework that identifies concrete targets and indicators that can be monitored and adjusted over time. In many cases, UNICEF staff directly provide drafting support but also help to identify and recruit outside expertise. UNICEF can also add significant value when the government is addressing cross-sectoral issues e.g. child protection, ECD, HIV/AIDS, nutrition, social protection and WASH. Here offices can showcase examples of strategies and plans developed in other countries, as well as serve as a convener and facilitator among relevant ministries. Developing a new sector strategy further presents an opportunity to highlight the potential return on investment and directly link to the economic growth agenda.

UNICEF should also play a significant role in supporting government counterparts to cost strategies and plans. Here a key lesson is the need to anchor costing exercises in actual budgets i.e. where the baseline builds on either the previous budget or the draft budget. Another practical lesson is to develop different cost scenarios so that the ministry can think through – and adapt to – alternative budget ceilings; this also forces counterparts to prioritize the most important programmes and activities. Where possible, UNICEF offices should invest in strengthening the costing skills of line ministry staff by bringing in external experts. Improved costing capacity can directly contribute to better-informed decisions on priorities and further empower line ministries to make more compelling funding pitches, both by providing a clear picture of the financing gap as well as by showcasing the potential returns that can be delivered through more resources (additional activities).

3.4.2. Budget preparation

Support line ministries to draft budget proposals

One of the most common opportunities identified in the country studies was for UNICEF to help counterparts better compete for scarce resources. While inter-sectoral budget allocation is partly a political matter, it is also a technical one. The reality is that line ministries that submit quality budget proposals (i.e. they reflect priorities and demonstrate strong value for money) are more likely to receive additional funding requests. Many studies found that social sector ministries were unable to convince the MoF to increase their original expenditure ceiling because there was no track record or evidence that the funds would be spent effectively and efficiently.

Here UNICEF can provide advice and technical support as social sector ministries develop their annual budgets. This could involve help with writing the budget and/or providing quality assurance to ensure that submissions: (i) directly link to existing strategies and plans; (ii) prioritize issues that require greater funding attention (worsening malnutrition trends, rising numbers of children not reached by vaccinations, shortages of ECD teachers, the negative impact of inflation on cash transfer programmes, etc.) as well geographic regions or population groups that have fallen behind; (iii) support the most cost-effective approaches (and conversely scale back spending on programmes that are not demonstrating strong value for money); and (iv) address recurring spending imbalances across service levels (e.g. favouring tertiary over primary services) or on the economic classification of the budget (e.g. focusing too many resources on salaries at the expense of spending on infrastructure or operations and maintenance). This is also an opportunity to use available evidence, including from budget briefs and other recent public finance analyses.

At the same time, UNICEF can help strengthen the justifications for budget submissions. This could include providing evidence-based research that demonstrates why spending more on a new or expanded programme is a good thing or simply helping with messaging. This is also a potential training opportunity that UNICEF could initiate, as the skills required to formulate and defend budget proposals are lacking in many ministries.

Within countries, UNICEF should prioritize support for administrative units that are under-resourced but strategically important for children. This naturally involves those that are focused on cross-sectoral issues e.g. child protection, ECD, HIV/AIDS, nutrition, social protection and WASH. In the country studies, there were strong examples of this type of support, such as to the Permanent Secretary for Social Protection in Burundi or the nutrition desk in the United Republic of Tanzania. However, this may also involve supporting multiple ministries when the mandates and functions are spread out. Empowered line ministries would serve as more effective counterparts to the MoF and would ultimately reduce the MoF's workload and influence in the early stages of the budget process.

One natural entry point to strengthen budget submissions is through sector working groups. Although these platforms do not determine the allocation of resources *across* sectors, they do provide an arena to monitor and, where needed, adjust allocations *within* sectors. In terms of influencing the upcoming budget, one simple action is to ensure that one or more meetings are organized in the period between the announcement of the budget ceilings and the submission of the sector budget proposals, which can be used to review and improve the current draft.

Dialogue with the Ministry of Finance

To either safeguard or argue for increasing spending on human capital sectors, a strategic entry point is to engage the MoF during the drafting of the budget. This could include when the budget strategy/framework paper is being put together and/or during inter-sectoral allocative decision-making processes. Most country studies found that it was not easy to meet the MoF at these stages. This is linked to the broader political economy context, especially when the MoF has a strong role in the budget process and there is little interest to involve external parties in allocative decisions.

Nevertheless, UNICEF should consider stepping up its advocacy efforts when budget ceilings are being established. In some countries where UNICEF has established deep relations with the MoF, advocacy is possible at a strategic level with the MoF. Here, UNICEF can call for maintaining a minimum level of expenditure for human capital sectors (or for increasing) by providing evidence on economic returns, making country comparisons and reminding the MoF of existing commitments (e.g. in national/sector plans or in international agreements, such as the Abuja Declaration, the Incheon Declaration, the Addis Ababa Action Agenda and the SDGs). If UNICEF fails to get direct access to the MoF, it can liaise with local partners or other DPs where access and influence with the MoF already exist.

More attention could also be paid to influencing transfers to sub-national levels. In some countries, there is room to improve the equity orientation of formulas to ensure that underfunded issues and/or regions benefit from at least a fair share of resources, if not an added boost to help poorly performing areas to catch up. Child protection, education and health services are commonly delegated to local levels and could potentially stand to benefit from this type of engagement. Data and evidence generation can be particularly powerful. In Malawi, the country office is supporting the Ministry of Health to review the existing formula, including by showcasing best practices from neighbouring countries. Another example is UNICEF's support to the Budget Monitoring and Accountability Unit of the Ministry of Finance, Planning and Economic Development in Uganda, which has involved developing an online dashboard that monitors allocations to human capital sectors alongside outcome indicators at the district level. Such information is very helpful to feed into national and local budget planning processes, as it identifies which sectors and regions are being underfunded.

3.4.3. Budget approval

Develop rapid budget analyses to influence parliamentary debate

Although the power of the parliament differs, the legislative body in all 16 countries does approve the national budget, thereby creating a universal advocacy entry point. The approach vis-à-vis parliament will vary from country to country. In countries where MPs run primarily on an individual agenda, with relatively weak party affiliations, providing reform-minded MPs (“champions”) with research and publications of voters’ spending preferences could be useful. In other contexts where party affiliations are relatively strong, it may be more difficult to influence individual MPs. If there is a strong opposition, UNICEF could consider supporting parliament with information on historical expenditure trends, as opposition MPs could use this to criticize the government and call for a rebalancing of the upcoming budget. However, UNICEF would need to move cautiously in such instances since this could adversely affect existing partnerships. To prevent political bias, an alternative approach could be to work with a local organization that has direct contact with MPs.

Irrespective of the political landscape, one powerful activity is developing a rapid analysis of the draft budget to influence parliamentary debate before approval. Many UNICEF offices have now institutionalized this process, including Angola, Malawi, Mozambique, Rwanda and Zambia. Here, the social policy teams spend up to a week analysing spending trends and offering concrete recommendations to improve the child sensitivity of the proposal. Given the time-sensitive nature of this activity, the recommendations commonly focus on inter-allocation issues (e.g. allocations to the WASH sector are significantly declining in real terms compared to the previous budget), but there are some instances where a more detailed analysis of human capital sectors or issues is undertaken (e.g. the budget to recruit new social workers falls far below the commitment in the new Social Protection Strategy). This information can either be shared with MPs individually and with parliamentary committees, or it can be presented at a public budget hearing.

Strengthen parliament’s budget oversight capacity

Beyond arming the parliament with recommendations to improve the child sensitivity of the draft budget, UNICEF can also work to strengthen its oversight capacity. MPs are not elected because of their financial knowledge, and even those sitting in budget or sector committees may not be well-versed in reading and understanding the budget. One simple activity is to host workshops to help them read and analyse the budget with a human capital lens. This strategically complements UNICEF’s work on budget briefs, and both the process to develop the content and the key findings could serve as the learning curriculum. However, many offices have gone a step further and developed formal training programmes to support both parliamentarians and key personnel in finance and social sector ministries to understand the budget and how it affects human capital development (Kenya, Lesotho, Malawi and the United Republic of Tanzania).

A longer-term option could be to establish or strengthen parliamentary budget offices to support routine budget analysis. Few of the countries studied had a budget office in place, and those that did were characterized by insufficient or unqualified staff which impeded the production of timely or meaningful information. One innovative approach is to create this function: this was done by the provision of UNICEF-supported staff inside parliaments in Malawi and Mozambique. In other contexts where some capacity does exist, such as South Africa, UNICEF collaborates closely to develop and share budget analyses.

3.4.4. Budget execution

Diagnose budget execution challenges in human capital sectors

When discussing investment in human capital, the level and impact of spending depends significantly on the quality of budget execution. One of the key bottlenecks identified in most of the country studies is that resources allocated to human capital sectors are not being fully absorbed. This means that monitoring and increasing the efficiency of spending should be a high priority for most UNICEF offices.

As a starting point, budget briefs are an excellent tool to routinely monitor budget execution trends. All 16 UNICEF offices that participated in this regional initiative are producing annual budget briefs that review social sector investment patterns. While some contain standalone sections that examine budget credibility, very few provide data and analysis on budget execution. As a result, expanding the content of the annual briefs serves as an outstanding entry point for most offices to begin to influence budget execution processes.

From there, UNICEF offices should go one step further and pinpoint budget execution problems. There are several possible channels to do so. One is through Public Expenditure Reviews (PERs). At the end of 2018, nearly all 16 UNICEF offices were either conducting or had recently completed one or more PERs – roughly half in collaboration with the World Bank and the other half alone. Although PERs are a great diagnostic tool, they rarely provide in-depth analysis of budget execution bottlenecks. It would therefore be strategic to ensure that any ongoing and future studies include robust data collection on budget execution (both quantitative and qualitative, and across multiple administrative levels), and for this to be reflected in a standalone chapter that describes challenges and remedial actions.

Public Expenditure Tracking Surveys (PETS) could also be considered. This public finance tool tracks the flow of funds from the Treasury through central ministries down to subnational governments, and ultimately to service delivery points. Although it is not explicitly focused on execution, it can provide insights if a sub-sector or major programme is experiencing leakage as resources move through the system, which could hamper execution. At the end of 2018, 6 of the 16 country offices were either supporting or had recently supported a PETS, demonstrating its potential to be replicated and adapted for budget execution purposes.

Another approach could be to initiate standalone budget execution assessments. For instance, UNICEF Lesotho and the World Bank jointly initiated a budget absorption capacity analysis of the health sector in 2018, with the aim of better understanding and correcting execution bottlenecks that severely affect capital spending. This is one of the first such studies ever undertaken and offers a good model for other offices.

Advocate for routine generation and analysis of budget execution information

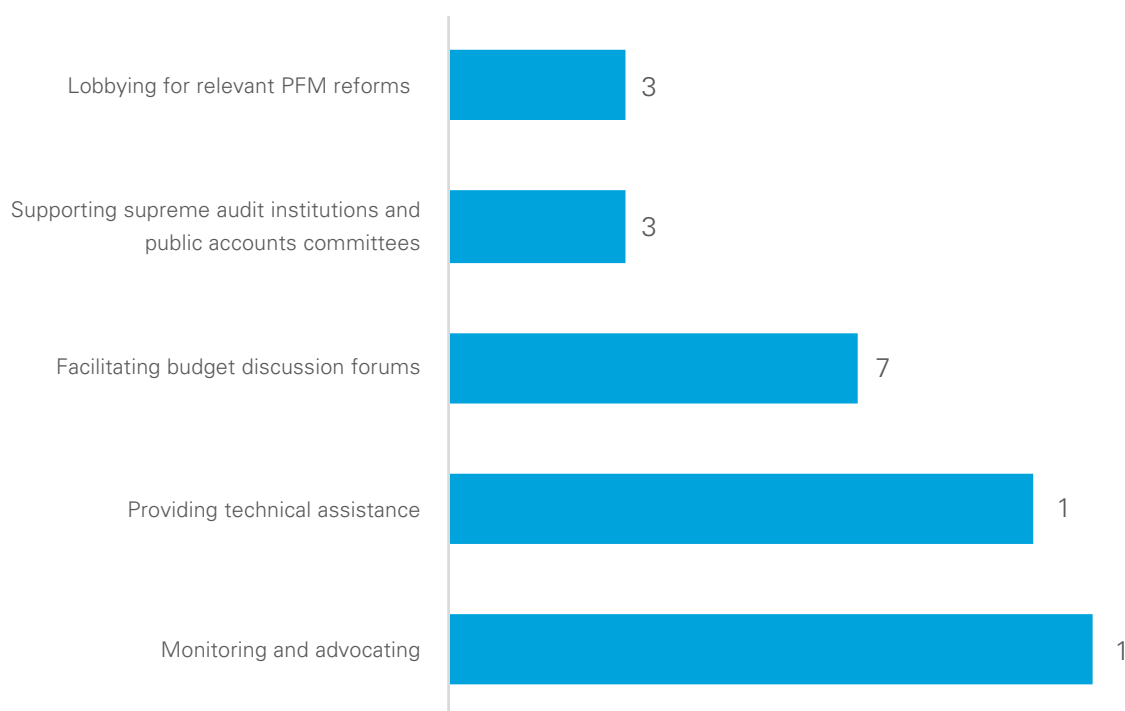
A somewhat alternative entry point is to convince the MoF to produce routine reports on budget execution performance. Having better and more timely execution information, including by multiple classifications (administrative, economic and programme) and at subnational levels, would allow for continuous monitoring and identification of spending challenges. In contexts where the integrated financial management information system (IFMIS) does not exist or is nascent, the first step would be to support system the development and strengthening of the system, which would need to be done with partners that have specialized expertise (e.g. the African Development Bank, the European Union, the IMF and/or the World Bank). Ideally, the government should have a robust internal monitoring system, with comprehensive analyses being produced and published

throughout the budget cycle (e.g. through in-year, mid-year and year-end expenditure reports and audit reports). One noteworthy example is from Madagascar, where UNICEF has helped the MoF to publish 2-3 yearly budget execution reports since 2016, which have been released as Citizens Budgets.

3.4.5. Budget transparency and accountability

The supply of and demand for budget information is essential to advocate for greater and more effective spending on human capital throughout the budget cycle. On the supply side, the countries studied have done a lot of work around monitoring, advocating and providing technical assistance to generate and publish more and better budget information in the public domain (Figure 3.03). Many of these activities were catalysed through UNICEF's regional initiative on budget transparency and will continue to serve as a strategic area of engagement. The demand side, however, remains largely unexploited by UNICEF. Here there are opportunities to establish or create platforms for citizens and the government to discuss and debate budget issues, especially during reviews of the budget proposal, as well as to engage with supreme audit institutions and public accounts committees – two actors that UNICEF offices have had very limited interaction with. Supporting one or more PFM reforms could also be a sensible approach where budget openness is a serious constraint. These opportunities are discussed below.

Figure 3.03. Main advocacy entry points identified in the budget cycle in the 16 political economy countries (in # of countries)



Monitor and advocate for better budget transparency

One of UNICEF's biggest opportunities is to continue actively monitoring budget transparency and advocating for improved practices. In 2017, UNICEF began working with the International Budget Partnership (IBP) to support efforts to monitor and improve budget transparency in the region. This included financial support to expand IBP's flagship product, the Open Budget Survey, in seven new countries (Burundi, Comoros, Eswatini, Lesotho, Madagascar, Somalia and South Sudan). The survey assesses the amount and quality of budget information that is produced in the public domain, along with parliament's budget oversight functions and the availability of opportunities for the public to contribute to budget processes. Following the release of the Open Budget Survey 2017 results, UNICEF and IBP jointly organized two regional workshops (one for Lusophone countries and one for others) in April 2018, in which 17 MoFs developed action plans to improve their transparency practices. In addition to leading to the publication of new budget documents, the workshops catalysed national events whereby various stakeholders discussed current transparency practices and opportunities. This engagement has been instrumental for many of the offices studied to initiate and/or deepen partnership with MoFs. Collaboration with the IBP has since been formally extended through 2020, with UNICEF financially supporting the Open Budget Survey 2019 in nearly all countries studied. The ongoing monitoring activities will continue to create entry points for UNICEF offices to work with MoFs on a variety of public finance issues, and should remain a high priority.

Provide technical assistance to improve budget transparency practices

Building on ongoing monitoring activities, UNICEF offices have many opportunities to support counterparts to produce more and better budget information. One key contribution has been the production of budget briefs, the majority of which are co-published with government and posted on MoF websites. Another important contribution is supporting MoFs to develop their Citizens Budgets, which occurred in several offices studied for the first time (Eswatini, Madagascar and Mozambique) as well as other UNICEF offices that were not part of the study (Somalia, South Sudan and Zimbabwe). As mentioned earlier, UNICEF Madagascar has also worked with the MoF to produce in-year Budget Execution Citizens' Reports. In addition, most offices have supported technical reviews of key budget documents prior to publication (e.g. Executive Budget Proposals and Year-End Reports). As UNICEF's partnerships with the IBP and MoFs grow, there should be ample opportunities to provide higher value technical support in the budget transparency domain.

One area that should be explored is at the subnational level. Here budget transparency efforts could build on UNICEF Uganda's approach to generate and analyse budget and performance data at the district level. Another innovation is in Malawi, where UNICEF supported the adaption of the Open Budget Survey at the district level, which could be replicated in other contexts as well.

Facilitate budget discussion forums

The country studies further demonstrated opportunities for UNICEF to create new processes to debate budget issues. The Open Budget Survey 2017 shows that ESAR is among the worst performing regions in the world in terms of budget transparency, but the situation is more unsettling when looking at the budget oversight and public participation components of the survey. To this end, many UNICEF offices could kill two birds with one stone by helping to initiate and institutionalize public hearings on the budget. In Malawi and Mozambique, UNICEF helped organize public hearings on the budget for the first time, which have since become institutionalized. In a sense, this approach allows parliament

to gain insights – and free recommendations – so that they can make meaningful changes before signing off on the budget, while also giving citizens the chance to voice concerns and help shape the budget. Beyond the approval stage, public forums can be held at other points in the budget cycle (e.g. to discuss the Executive's Budget Proposal, the Mid-Year Report and the Audit Report), which can similarly contribute to parliament's oversight function and improve public participation. All of these entry points can be explored by UNICEF offices.

Support supreme audit institutions and public accounts committees

Support to supreme audit institutions (or courts of auditors) also helps to construct a climate of accountability and justice, and to encourage more efficient spending. The budget approval stage is not the only phase where MPs can engage in the budget. One good opportunity that is rarely seized in the region is for MPs to follow up on the recommendations issued by the auditor general, especially through the public accounts committees. MPs in these committees should be targeted in any formal training programmes initiated by UNICEF and could also benefit from support to review budget execution reports and auditor general reports.

Lobby for relevant PFM reforms

In country contexts where entry points are scarce, lobbying for the adoption of certain PFM reforms could make sense. Despite UNICEF's widespread engagement in budget transparency, many of the countries studied have limited opportunities to influence budget processes. The reasons vary from political unrest (e.g. Burundi) to low compliance to existing legislation (e.g. Malawi) to generally closed budget processes (e.g. Comoros). In these cases, UNICEF could team up with other partners to support PFM reforms that improve budget transparency and participation, which should ultimately lead to better opportunities for advocacy and dialogue. This could include expanding the PFM law to require publishing of internal budget information (e.g. on execution), revising the Chart of Accounts and/or introducing programme-based budgeting in one or more social sectors. In the long run, supporting these types of reforms will create a stronger PFM system that should foster more transparent and open budget process.

CHAPTER 4.

CONCLUDING THOUGHTS

Four key findings emerge from the fiscal space and political economy analyses that were recently conducted in 16 ESAR countries. First, the regional outlook for expenditure on human capital is characterized by both hope and discouragement. Second, all countries have at least one very strong option to create fiscal space in support of greater investments in human capital, while most countries have a variety of promising options that can be explored. Third, creating fiscal space, in practice, requires overcoming significant challenges. And fourth, opportunities abound for UNICEF country offices to influence PFM processes and support the progressive scale-up of investment in sectors that are fundamental to child well-being and the formation of human capital. These findings are discussed below.

4.1 The outlook for expenditure on human capital

It is likely that investment in core human capital sectors will slightly decrease overall for the region in the near term, but this will vary significantly across countries. Based on the modified macro-fiscal programming models, real per child expenditure was projected to decline by an average of about 6 per cent over five-year periods. At the country level, however, the outlooks were very diverse. Five countries were projected to undergo deep contractions in real per child expenditure (between 10 and 30 per cent) and three to have smaller declines (in the 2-5 per cent range), while modest increases (around 3.5 per cent) were forecast in two countries and substantial rises (between 20 and 90 per cent) in six countries.

The projection exercises show that investment outlooks are inherently tied to economic outlooks. Most of the countries that were projected to experience declining expenditure over the near term were those where recent sluggish or no growth economic situations were expected to continue, such as in southern Africa. This highlights a critical reality: fiscal space can shrink. On the other side, booming economies in places like Kenya, Rwanda and the United Republic of Tanzania were linked to high expectations for greater expenditure on human capital. Angola was the major exception, which is the country where the biggest growth in expenditure was projected to occur according to the baseline scenario. As discussed, its economic outlook is not great once adjusting for changes to prices and the size of the population. However, early in 2018 the government committed to increase the budget priority given to the education and health sectors in order to progressively fulfil its commitments to the Abuja Declaration and Education for All by 2022. While time will tell whether such promises come to fruition, this instance demonstrates that politics can supersede economics in terms of affecting investment trajectories.

4.2 Options to boost expenditure on human capital

There is no shortage of strategies available to governments if they are serious about developing the human capital bases of their countries. A review of information from global databases and the macro-fiscal programming models showed that all countries have, at a minimum, one very strong option to raise expenditure over the near term. One group of countries – Botswana, Malawi, Rwanda, Uganda and the United Republic of Tanzania – were found to have at least four high-potential categories available for further investigation, while Angola, Kenya, Lesotho, Namibia and Zambia had three each. Some

of the most promising areas at regional level are highlighted below.

Reprioritizing the budget appears to be the most promising avenue to enhance fiscal space in the region. The country projections showed this to have the biggest potential returns. Reallocating resources away from non-priority areas to human capital sectors was found to potentially increase real per child expenditure by around 6 per cent annually above the baseline scenarios, on average. When combined with other data, reprioritization was identified as having very strong potential in 13 of the 16 countries studied.

Increasing revenue is another promising pathway. While most countries are expected to benefit from natural revenue growth, rising prices and populations will subdue the impact of larger budgets on the development of human capital. Nonetheless, the low capacity to extract taxes from the economy observed in many countries underscores the opportunities for domestic resource mobilization. Some governments may be able to introduce new taxes (e.g. on property) or to raise existing VAT, CIT and PIT rates. However, this may not be politically feasible in contexts of fiscal austerity or slow growth. In contrast, strengthening tax collection capacity appears to be the most realistic approach for most governments.

Other good options to augment fiscal space in sub-groups of countries include advocating for more ODA, cracking down on IFFs and addressing spending inefficiencies. On the ODA front, attracting grants and concessional loans is a particularly good option for LICs. If they can convince donors that additional resources will deliver strong value for money and be accompanied by robust accountability mechanisms, many governments can make a compelling case for increased funding given the prevailing human capital deficits. Meanwhile, addressing IFFs is one of the more intriguing approaches for the region. The estimated magnitude of flows is staggering in many countries, and any actions that can prevent, capture and effectively tax these resources could go a long way to raising expenditure on human capital. Lastly, the review of budget credibility rates in the education and health sectors revealed the severity of one major type of spending inefficiency, especially for capital items, which has received little attention in most countries and affects actual levels of investment in human capital. Strengthening the design of budgets as well as reducing leakages and waste could also bolster the impact of human capital budgets across the region.

4.3 Fiscal space headwinds

Despite the ample opportunities, the fiscal space outlook is far from ideal. Every seemingly great idea at country level must overcome a variety of challenges to both create new resources and then direct them into human capital sectors.

- **Reprioritization:** Human capital is often not a high budget priority for politicians, who are much more inclined to invest in things that keep them in power either physically (e.g. defence and public administration) or by helping to garner future votes through quick, visible results (e.g. transport, roads, energy, agriculture and subsidies). Successful reprioritization therefore requires overcoming the political incentives that underlie budget allocation decisions, which is not an easy task in any context. Debt accumulation adds additional complications in many countries, as growing repayment burdens further reduce flexibility for reallocating resources.
- **Revenue:** Real GDP growth has been disappointing in most countries and has hampered natural revenue growth. As such, if governments cannot work more effectively with the private sector and generate higher rates, larger human capital budgets are very unlikely. At the same time, while improved tax administration may be one of the best prospects in the region, most revenue authorities have had strategies in place for many years. This indicates that meaningful tax collection gains will be difficult to realize in

the near term in the absence of a major push by both politicians and technocrats – and of course greater willingness from citizens and business to pay their dues.

- **ODA:** Free and/or cheap money should always be a good thing, but over-dependence and persistence of parallel systems can distort domestic investment priorities, undermine national capacity and plans, and lead to duplication of activities and hence wastage, among other problems. Traditional donor funding will also be increasingly more difficult to come by for the new LMICs in the region, as donors are committed to better targeting ODA toward the least developed countries.
- **IFFs:** Some of the key actions to deal with IFFs are related to eliminating tax evasion and hence strengthening tax administrative capacity, which was already noted as a complex and timely process. Many others are related to corruption – at borders, in procurement processes, in facilitating illegal activities and so on. While gathering better information on the scope of flows and effective responses acts as another barrier at the country level, improving tax administration and ending cultures of corruption are tall orders.
- **Spending efficiencies:** Improving the implementation of budgets in human capital sectors requires successfully addressing diverse bottlenecks. At central level, these can range from inaccurate revenue forecasting and weak spending controls to slow disbursement processes and imperfect financial management information systems; at the sector level, this can involve the limited availability of skilled personnel, flawed budget designs and plans, poor cash management practices, complex and/or non-competitive procurement processes, donor funding delays and so on. In other words, there are no easy fixes to the multitude of technical challenges.

4.4 Opportunities for UNICEF to influence the investment climate

The political economy analyses revealed numerous opportunities for UNICEF to more effectively engage in PFM processes and explore the fiscal space strategies identified above. While these are inherently context-specific and must be tailored to policy and budgeting dynamics and actors at country level, many common entry points are evident across the region. As the report presents, these cut across the budget cycle as well as the budget transparency and accountability agenda.

- **Strategic dialogue and planning:** Although spaces for external actors to influence policy dialogue have decreased in recent years, channels exist both inside and outside formal budget processes to introduce messages about the importance of investing in human capital. At the national level, it is important to develop the right “pitch,” which could potentially include the demographic boom, the economic growth agenda, social protection and/or decentralization. This may require developing investment cases that demonstrate the returns on investment or the economic costs of not investing more in particular area. With the MoF, offices should place special attention on initiating and cultivating strong ties around child-responsive budgeting, which could focus on strengthening budget guidelines as well as budget framework papers to better reflect the needs of children. At the sector level, where UNICEF has its strongest relationships, helping to cost strategies and plans presents a universal opportunity; if it is unclear what the resource needs are and how additional resources will be used, ministries will have little hope of attracting significant new funding.
- **Budget preparation:** Budget proposals are one of the most important determinants of whether a sector will be granted an additional funding request during negotiations with the MoF. The political economy studies frequently identified that the quality of budget proposals was underwhelming and support to strengthen them could be

extremely valuable. This would also provide a natural opportunity to guide the design of sectoral budgets, ensuring that they are directly linked to existing strategies and plans, focused on key priorities and geographic regions and population groups that have the greatest needs, support the most cost-effective interventions, and reflect the optimal balance of spending across service delivery levels as well as recurrent and capital items. A related constraint commonly noted was the weak position of social sector ministries to dialogue with the MoF. Here, UNICEF can leverage its partnership with the MoF to both open and support discussions with line ministries as soon as the budget ceilings are established.

- **Budget approval:** Once the national budget has been drafted, UNICEF has a great opportunity to support the parliament's review of the proposals. Several offices have very successfully carried out rapid analyses to highlight concerning allocative trends among human capital sectors, which were then used to influence parliamentary debate and inform recommendations before the budget was approved. There are also strategic entry points to strengthen the parliament's budget oversight capacity. Successful approaches that could be replicated include developing formal training programmes to enhance the understanding of MPs of how the budget affects children and contributes to human capital as well as helping to establish budgetary analysis functions inside parliament, including through parliamentary budget offices. The budgetary oversight powers of parliaments vary widely across the region, so these approaches should be weighed against their potential to affect investment decisions vis-à-vis engaging with line ministries and the MoF.
- **Budget execution:** The quality of budget execution has a direct impact on the amount and impact of investment in human capital sectors. Given this, arguably one of UNICEF's biggest contributions to enhancing fiscal space is supporting counterparts to improve the implementation of their budgets. While all 16 country offices are monitoring sector budgets through annual budget briefs, very few are obtaining execution data, which emerges as a universal low-hanging fruit. From there, offices could begin to diagnose the underlying bottlenecks and identify solutions, which could be done through dedicated sections in PERs and PETS or through standalone budget execution assessments. There may also be strategic openings to work with the MoF to generate disaggregated budget execution data so that routine performance monitoring becomes institutionalized across the budget cycle.
- **Budget transparency and accountability:** The ability to advocate for greater funding for human capital sectors ultimately starts with having access to reliable information and meaningful discussion platforms. One big opportunity for UNICEF is to continue actively monitoring budget transparency and calling for improved practices, which most offices have done since 2017 in close partnership with the IBP. This has increasingly involved providing technical assistance, including to help MoFs to develop Citizens Budgets and transparency web portals as well as to expand the amount of information contained in budget documents. Several country offices have also organized public hearings at various stages of the budget cycle, which is a great approach that could be replicated in many contexts. Another opportunity is to work with DPs to support relevant PFM reforms, such as updating PFM laws, revising the Chart of Accounts or introducing programme-based budgeting, all of which can strengthen PFM systems to generate more and better budget information.

4.5 The final thought

Fiscal space for children and human capital is a big challenge. Identifying an opportunity is one thing; creating fiscal space in practice – i.e. overcoming the headwinds – and then transforming it into greater investments in human capital sectors – i.e. influencing the politics that underlie budget allocation decisions – are entirely different and complex processes. Nonetheless, the critical starting point is to understand the likely human capital investment trajectory. And while the modelling exercises suggested mixed outcomes, the very low human capital bases in all countries mean that maximum efforts should be devoted to increasing expenditure as quickly as possible. UNICEF's challenge is therefore to influence that trajectory.

The country studies offer a strategic road map. In all the contexts, the fiscal space analyses identified at least one category that shows strong potential over the near term. From here, it is important to update and re-evaluate those promising scenarios, and to develop a plan to operationalize the best ideas. As revealed in the political economy analyses, although daunting, country offices can navigate forward by adapting to the dynamics of the budget process. They can also pursue multiple strategies, recognizing that small amounts of fiscal space from different sources can significantly alter the investment trajectory and – if well used – transform children's lives and the economic and social outlooks of their countries.

ANNEX 1.

STEPS TO CARRY OUT THE FISCAL SPACE PROJECTION EXERCISES

Step 1. Compile historical data for a first projection analysis and update for subsequent projection analyses

1. “State-of-the-world” annual variables:

- A. Growth rate of volume of world trade
- B. Growth rate of the year-average world price-level indicator (e.g., U.S. GDP deflator, World Bank Manufacturing Unit Value index, etc.
- C. Growth rates of relevant international export (e.g. relevant mining and other export commodity prices) and import prices (e.g. crude oil).
- D. World interest-rate indicator (e.g. London Interbank Offered Rate or LIBOR)

➡ *Note: These data are available from the IMF's World Economic Outlook Database.*

2. Key macroeconomic indicators:

- A. Growth rate of real GDP
- B. Growth rates of key sectoral output values (e.g. oil)
- C. Growth rate of year-average and year-end price-level indicators (e.g. consumer price index, GDP deflator)
- D. Growth rate of year-average and year-end exchange-rate indicators
- E. Growth rate of overall population
- F. Growth rate of population cohorts (e.g. persons of school age, persons past working age, etc.)

➡ *Note: These data should be available from country sources. Monthly price-level and exchange-rate data are also available from the IMF World Economic Outlook Database, while population growth rates are available from UN DESA World Population Prospects: 2017 Revision.*

3. National-expenditure accounts:

- A. Overall Investment (including gross fixed capital formation, net increase in inventory stocks
- B. Exports and imports of goods and non-factor services:
 - i. Merchandise exports by commodity type
 - ii. Non-factor services exports
 - iii. Merchandise imports by import category (consumption, oil, non-oil intermediate, capital)
 - iv. Non-factor services imports
- E. Government consumption
- F. Non-government consumption

➡ *Note: These data should be available from government sources.*

4. Overall executed central-government budget accounts:

- A. Non-interest expenditure flows, classified by expenditure sector (education, health, etc.) and subclassified by economic category (staff remuneration, non-staff goods and services, other current expenditure, gross fixed capital formation, and other capital expenditure).
- B. External and internal interest due
- C. Revenue flows, classified into tax and non-tax revenue, with tax revenue subclassified into revenue type (personal income tax, company income tax, excises, value-added tax, customs levies, etc.)
- D. Financing flows, classified into external and internal financing flows

➡ *Note: These data should be available from government sources.*

Step 2. Set programming assumptions for each projection analysis (and review and reset, as required)

1. Assumptions for the “state-of-the-world” annual variables:

- A. Growth rate of the world trade volume
- B. Growth rate of the year-average world price-level indicator (e.g., U.S. GDP deflator, World Bank Manufacturing Unit Value index, etc.)
- C. Growth rates of relevant international export (e.g. relevant mining and other export commodity prices) and import prices (e.g. crude oil).
- D. World interest-rate indicator (e.g. LIBOR)

2. Assumptions for the key macroeconomic indicators:

- A. Growth rate of real GDP
- B. Growth rates of key sectoral output values (e.g. oil)
- C. Growth rate of year-average and year-end price-level indicators (e.g. consumer price index, GDP deflator)
- D. Growth rate of year-average and year-end exchange-rate indicators
- E. Growth rate of overall population
- F. Growth rate of population cohorts (e.g. persons of school age, persons past working age, etc.)

3. Assumptions for the national-expenditure accounts:

- A. Investment:
 - i. Incremental capital-output ratio (to determine overall gross fixed capital formation)
 - ii. Growth rate of the net increase in inventory stocks
- B. Exports and imports of goods and non-factor services:
 - i. Merchandise exports by commodity type:
 - a. Growth rate of volume (depending on world market growth rates)
 - b. Growth rate of the unit price
 - ii. Non-factor services exports:
 - a. Growth rate of volume (depending on world market growth rates)
 - b. Growth rate of the unit price

- iii. Merchandise imports by import category (consumption, oil, non-oil intermediate, capital):
 - a. Growth rate of volume (depending on real GDP growth)
 - b. Growth rate of the unit price
- iv. Non-factor services imports:
 - a. Growth rate of volume (depending on world market growth rates or on merchandise imports)
 - b. Growth rate of the unit price

4. Assumptions to determine central-government budget accounts:

- A. Growth rates of non-interest expenditure flows classified by expenditure sector and subclassified by economic category.
- B. Interest rates on external and internal debt
- C. Growth rates of revenue flows
- D. Growth rates of external-debt disbursements to the central government
- E. Growth rates of external-debt repayment by the central government

Step 3. Calculate projections of the national-expenditure and the fiscal accounts

1. Complete the multiannual projections of the national-expenditure accounts – that is, calculate the residual-account calculation of non-government consumption for each projection year by applying the national-expenditure accounts identity.
2. Complete the multiannual projections of the central-government accounts – that is, calculate the residual-account calculation of the net increase in the net internal debt by applying the fiscal-accounts identity.

Step 4. Evaluate the projection results, according to different criteria

1. Would projected real expenditure on priority sectors grow adequately based on the existing funding gaps?
2. Would the projected increase in the net internal debt be larger than internal financial markets could bear? In particular, would the central government's internal debt grow too rapidly as a percentage of GDP?

ANNEX 2.

METHODOLOGY FOR STANDARDIZING THE MACRO-FISCAL PROGRAMMING MODELS

This annex describes the methodology used to standardize the macro-fiscal programming models in order to allow for very preliminary comparison of the evolution of per child expenditure on core human capital sectors according to the baseline and select alternative scenarios across the 16 countries. It describes the adjustments made to the baseline and alternative scenarios. This is followed by a discussion of the main caveats and interpretative warnings.

Adjustments to the baseline scenarios

The steps taken to estimate comparable projected results for the baseline scenario are listed below, while Table 1 summarizes the key differences between the original models and the adjusted models.

1. Extract expenditure (all available sectors), GDP (nominal as well as constant US\$ and exchange rates) and CPI data for all years covered (historical and projections) in the baseline scenarios for each of the 16 models, which reflect all of the original assumptions built into each model as presented in the “projection” output sheets and described in each country report.
2. Compare nominal and constant US\$ and exchange rates, as well as CPI data in each model, with those presented in the IMF World Economic Outlook Database (October 2018) to double check the accuracy of the information.
3. Convert all data reported in thousands, millions and billions to actual values.
4. Calculate the local currency value of total human capital expenditure for all years using a universal definition of human capital that consists of the education, health and social protection sectors⁴⁸ (Note: The child protection, nutrition and WASH sectors were excluded as they were not covered in all 16 studies and would therefore limit the accuracy of cross-country comparisons).
5. Calculate human capital expenditure as % of GDP for all years by dividing the local currency value of human capital expenditure by the local currency value of GDP.
6. Calculate per child expenditure on human capital in constant US\$ and exchange rates for all years by multiplying expenditure as % of GDP by GDP in constant US\$ and exchange rates⁴⁹ and then dividing by the total population aged 0-17 (based on UN DESA World Population Prospects: 2017 Revision, medium variant estimates).
7. Calculate the projected change of expenditure per child on human capital in constant US\$ and exchange rates after five years by comparing the average value of the most recent two years of actual data with the predicted value in year 5 of each model.⁵⁰

⁴⁸ Coverage for all three sectors is universal across the sample except for Comoros, which did not include social protection.

⁴⁹ The conversion base year varied for the country studies from 2006 (Botswana), 2014 (Lesotho and South Africa) and 2016 (Angola and Kenya), with all other countries using 2015.

⁵⁰ The projection periods varied across the sample: ten countries used 5 years, one 6 years, three 7 years, one 8 years

Table 1. Summary of main differences between the original and adjusted models in the baseline scenario

Parameter	Original model	Adjusted model
Definition of human capital	National (combination of child protection, education, health, nutrition, social protection and WASH)	Education, health and social protection
Definition of the child population	National (ranges from the under 15 to under 20 population)	0-17
Base year of results	First year of projection period	Average value of the latest two years of actual information
End year of results	National (ranges from projection year 5 to projection year 10)	Projection year 5

Adjustments to the alternative scenarios

The steps taken to isolate the extra fiscal space exclusively created by each alternative scenario and to compare the projected results after five years relative to the baseline results are listed below. Table 2 then summarizes the key differences between the original models and the adjusted models.

1. Preserve the standardization of variables as described above in each of the 16 models, including the definitions of human capital sectors (education, health and social protection) and the child populations (aged 0-17).
2. Adjust the financing assumptions of each alternative scenario in all country models so that the levels of internal and external debt and debt repayment are the same as those in the baseline scenarios for all years; the one exception is for the alternative scenarios that involved increasing debt to finance greater expenditure on human capital, whereby the assumptions built into the alternative scenarios were maintained.

Important clarifications for this step: One key feature of the alternative scenarios presented in the country reports is that the additional fiscal space that was generated was not exclusively used to increase expenditure on human capital sectors. In contrast, most alternative scenarios directed at least a portion of the new resources toward the repayment of internal and/or external debt over time, resulting both in lower debt levels and in increased (or not) expenditure per child at the end of the projection period relative to the baseline scenario. Some alternative scenarios also used additional fiscal space to support non-priority expenditure. In practice, this means that many

and one 10 years.

Table 2. Summary of main differences between the original and adjusted models in the alternative scenarios

Parameter	Original model	Adjusted model
Definition of human capital	Combination of child protection, education, health, nutrition, social protection and WASH	Education, health and social protection
Definition of the child population	Ranges from the under 15 to under 20 population	Under 18
End year of results	Ranges from projection year 5 to projection year 10	Projection year 5
Debt repayment	The same or greater than the baseline scenario	The same as the baseline scenario
Use of fiscal space	For debt repayment, human capital expenditure or a combination of both	Only for human capital expenditure

alternative scenarios did not demonstrate the entire potential of a fiscal space option to benefit investment in human capital, which was one of the main objectives of this regional report and hence the rationale for the adjustments.

3. Re-run the model to estimate the value of expenditure per child on human capital in constant US\$ and exchange rates in projection for year five based on the above modifications.
4. Calculate the difference between the above value and the value of per child expenditure on human capital in constant US\$ and exchange rates as predicted under the baseline scenario in year five.

Caveats

Despite the above changes to the baseline and alternative scenarios, there are important limitations to the accuracy of predictions as well as cross-country comparisons presented in this report. First, all scenarios – including the baseline – are laden with assumptions, and increasing or decreasing future optimism about one or more indicators would likely produce a very different set of results. Second, the values of all data inputted into the models were ultimately converted into constant US\$ and exchange rates for analytical purposes. Presenting the information in real local currency value, PPP or constant international US\$ would therefore also affect the results. And third, most of the indicators that were included in the models have already been updated, as the macro-economic and fiscal situation has evolved in each country. This means that the estimates presented would further change if the latest information were inputted into each model and the baseline and alternative scenarios were re-run.

The cross-country comparisons should also be interpreted with great caution. This starts with the variety of country-specific issues just described. Beyond those, the definition and identification of education, health and social protection expenditure varied across the sample, which means that the levels nor the changes over time in human capital expenditure cannot be effectively compared across countries. There are further challenges to comparing the levels of human capital expenditure due to the use of different base years for converting local currency values into constant US\$ and exchange rates.

Caveats aside, the above restrictions underpin most modelling exercises and cross-country analyses, which are only intended to be illustrative. This applies resoundingly to all findings from the country models as well as those from the modified macro-fiscal programming models presented in this report. As such the country and regional-level analyses are only intended to offer a very preliminary idea of fiscal space options and strategies that could be considered for further investigation and discussion in an open dialogue at country level, and should not be taken at face value.

ANNEX 3.

FISCAL SPACE COUNTRY PROFILES: THE METHODOLOGY

This annex describes the methodology used to assess the near-term fiscal space outlooks for the 16 countries as presented in Table 2.01 and Table 2.02 in Section 2.6 of the report. The main steps are summarized below.

1. Convert all of the projected results generated by the adjusted macro-fiscal programming country models (and presented in Section 2.5) from changes in real per child expenditure on human capital over a five-year period to average annual changes, which was simply carried out by dividing them by five.
2. Next, all of the indicators presented in Section 2.5 were transformed into a single database, which included all of the modelled scenarios as well as information drawn from global database. The different indicators were also aligned to the seven general categories of fiscal space examined in the report, which included revenue, ODA, reprioritization, efficiency of spending, borrowing, fiscal savings and IFFs.
3. Transform 15 fiscal space indicators presented in Section 2.5 into a single database, organized by the general seven general categories.
4. Develop thresholds for all 15 indicators to determine fiscal space potential (low, medium and high). The thresholds are presented in Table 3 at the end of this Annex along with the summary statistics of the sample and the data sources.
 - Notes: Quartile values were used to determine most cut-offs, but in some instances this was not possible or did not make sense. These included: (i) tax revenue as a percentage of GDP (high potential was defined as anything below the average for sub-Saharan Africa: 15.6 per cent); (ii) debt distress ratings (medium potential was defined as a low rating by the IMF with everything else low potential); and (iii) the establishment of a sovereign wealth fund (high potential meant a fund existed and everything else was low). In addition, given that the results from the alternative scenarios presented in this report showed positive improvement over the baseline scenario results in all countries, the threshold value for each of these indicators was used to define between “medium” or “high” potential only.
5. Apply the thresholds to estimate the fiscal space potential for each country based on the 15 indicators, where applicable (i.e. the thresholds were not applied in instances where a country did not have an alternative scenario presented or a debt distress rating). The results are presented in Table 2.01 in Section 2.6 of the report.
6. Estimate the categorical fiscal space potential for each country based on the average values of the available indicators. This was not possible for the fiscal savings or IFFs categories as there was only indicator for each. The results are presented in Table 2.02 in Section 2.6 of the report.

Table 3. Indicators and thresholds to determine fiscal space potential

Category	Indicator	Fiscal space threshold determinants				Summary statistics					Source
		low	medium	high	based on	average	standard deviation	quantile 1	quantile 2	quantile 3	
Natural fiscal space	1. average annual change of real per child expenditure on human capital over 5-year period (as %)	0.15	< n <	5.70	Quartiles	-1.2	6.8	-2.4	0.1	5.7	modelling projections
	2. average annual change of real per capita general government revenue, 2019-21 (as %)	0.01	< n <	3.03	Quartiles	1.4	2.2	0.0	1.1	3.0	IMF projections
Revenue	3. average annual increase of real per child expenditure on human capital above baseline scenario over 5-year period (as %)	na	n <	3.07	Quartiles	2.2	1.7	0.9	1.3	3.1	modelling projections
	4. tax revenue, latest available (% of GDP)	23.97	> n <	15.64	SSA avg and 75 percentile	18.9	7.9	12.8	15.8	24.0	IMF projections
ODA	5. average annual increase of real per child expenditure on human capital above baseline scenario over 5-year period (as %)	na	n <	1.67	Quartiles	3.4	...	1.7	2.0	4.9	modelling projections
	6. average change of real per capita net and official ODA, 2016-18 and 2019-21 period averages (as %)	0	< n <	5.51	Quartiles	8.3	15.8	-3.4	5.5	16.8	projections based on OECD
Reprioritization	7. average annual increase of real per child expenditure on human capital above baseline scenario over 5-year period (as %)	na	n <	1.07	Quartiles	6.4	...	1.1	3.4	9.1	modelling projections
	8. military-to-health expenditure ratio, 2017 or latest available (as %)	0	< n <	0.15	Quartiles	0.3	0.3	0.1	0.2	0.3	SIPRI, WHO
Spending efficiency	9. average annual increase of real per child expenditure on human capital above baseline scenario over 5-year period (as %)	na	n <	1.54	Quartiles	2.5	...	1.5	2.4	3.4	modelling projections
	10. education and health sector budget credibility rates, latest available 3-year average (as %)	0.97	< n <	0.78	Quartiles	0.9	0.1	0.8	0.9	1.0	budget briefs, PERs, PEFA, BOOST
Borrowing	11. average annual increase of real per child expenditure on human capital above baseline scenario over 5-year period (as %)	na	n <	3.27	Quartiles	2.8	...	1.2	1.6	3.3	modelling projections
	12. debt distress rating, latest available	moderate or above	low	na	Ratings	...	...	...	...	...	IMF DSAs
Fiscal savings	13. general government gross debt, 2019 (% of GDP)	49.34	> n >	38.56	Quartiles	52.9	23.7	38.6	49.3	59.1	IMF projections
	14. sovereign wealth fund established	no	na	yes	Fund exists	...	...	...	...	...	Sovereign Wealth Fund Institute
IFFs	15. IFFs, 2011-13 period average (% of GDP)	3.2	< n <	8.12	Quartiles	7.9	5.8	3.2	8.1	12.0	Global Financial Integrity

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