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POLICY BRIEF

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 POLICY BRIEF

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.

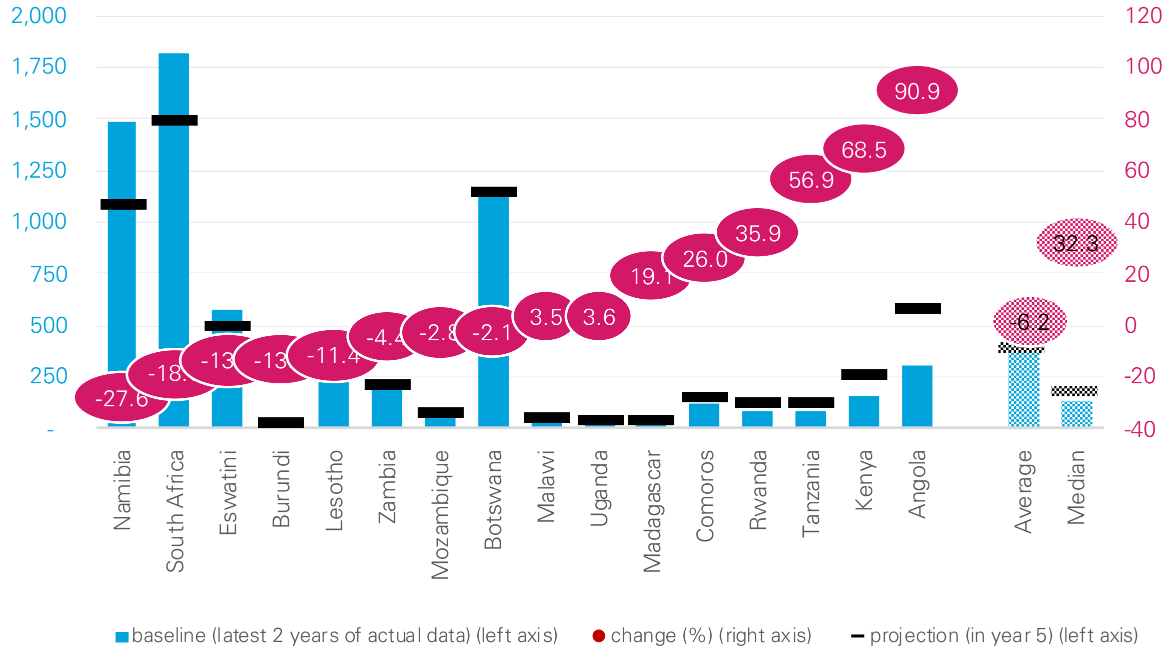
Drawing on information from the country studies as well as global databases, four key findings emerge. First, the regional outlook for expenditure on human capital is characterized by both hope and discouragement. Second, all countries have at least one very strong option to create fiscal space in support 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 public finance management (PFM) processes and support the progressive scaling up of investment in sectors that are fundamental to child well-being and the formation of human capital. These findings are discussed below.

The outlook for expenditure on human capital

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 (Figure 1).

The projection exercises show that investment outlooks are inherently tied to economic outlooks. Recent sluggish or no growth economic situations were expected to continue in most of the countries that were projected to experience declining expenditure over the near term, such as in southern Africa. This highlights a critical reality: fiscal space can shrink. On the other side, fast-growing 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 modelling scenarios. Although its economic outlook is not great once adjusting for price changes and the size of the population, in 2018 its 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.

Figure 1. Change in human capital investments after a five-year period based on the baseline scenarios (in per child constant US$ and as %)



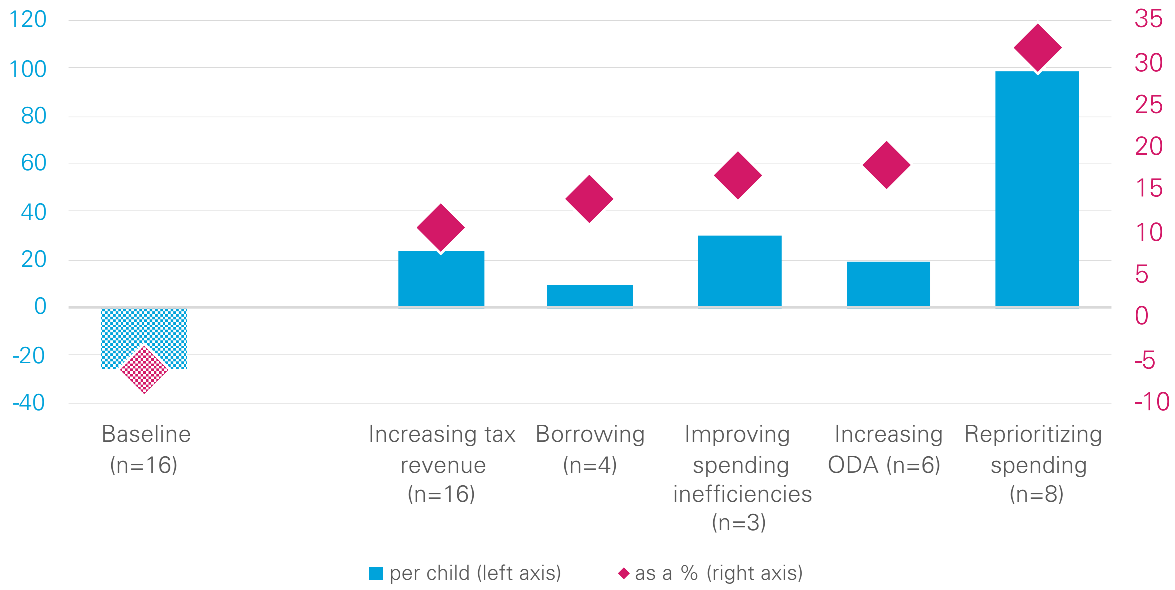
Sources: See Figures 2.12, 2.15, 2.18, 2.22 and 2.28 as well Annex 2 to the main report for a description of the methodology.
Notes: Human capital investments are defined as those in education, health and social protection; the child population is all persons 0-17; the base year for constant US$ and exchange rates varies across the sample.

Options to boost expenditure on human capital

The second finding is that there is no shortage of strategies available to governments if they are serious about developing the human capital bases of their countries. Seven categories of fiscal space were assessed. These included: (i) increasing government revenue; (ii) increasing official development assistance; (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. The Annex presents the country-by-country findings, while some of the strongest 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. In eight modelling exercises, 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 (Figure 2). Moreover,

Figure 2. 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 as Annex 2 to the main report 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.

as a hypothetical exercise, most governments could easily achieve core human capital spending benchmarks if they re-directed half of their recent military budgets to the education and health sectors. Overall, reprioritization was identified as having very strong potential in 13 of the 16 countries studied.

Increasing domestic revenue is another strong fiscal space pathway. Most countries are expected to benefit from natural revenue growth, but rising prices and bigger populations will subdue the impact of larger budgets on the development of human capital as goods and services will be costlier and need to support more beneficiaries. Nonetheless, 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 low by global standards and underscores the opportunities for domestic resource mobilization. Some governments may be able to introduce new taxes (for example on property) or to raise existing value added, corporate income and/or personal income tax rates. Different combinations were modelled in all countries, showing the possibility of increasing real per child expenditure on human capital sectors by an average of just over 2 per cent above the baseline scenarios every year (Figure 2 above). However, this may not be politically feasible in countries undergoing fiscal austerity or slow growth, which characterize many contexts. In contrast, strengthening tax compliance and enforcement capacity appears to be the most realistic approach, which was found to be a medium- or high-potential option for all governments studied.

Addressing spending inefficiencies is another significant opportunity to improve the actual levels of investment in human capital sectors across the region. One way to measure spending efficiency is through budget execution rates, which show the difference between the volume of resources released to a spending agency during a fiscal year and the volume of resources used by the end of the year. If the budget execution rate is less than 100 per cent, not all the funds made available are spent, and unused funds are often transferred to other ministries or returned to the Ministry of Finance (MoF) or Treasury. In either case, resources that were once available in a human capital sector are, in effect, "lost," thereby reducing fiscal space. The modelling results from three countries showed that progressively enhancing budget execution rates in one or more human capital sectors could increase real per child expenditure by an average of 4 per cent annually above the baseline scenarios (Figure 2 above). Given the difficulties in obtaining budget execution data, the report also reviewed budget credibility rates in human capital sectors from various public finance studies. These compare the volume of resources approved at the start of the year and the volume spent at the end of the year, and serve as a decent proxy for budget execution performance. When looking at the latest available three-year averages, capital budget credibility rates were 67 and 65 per cent for the education and health sectors respectively, on average, further demonstrating the unexploited potential of this approach in most countries.

Advocating for more official development assistance (ODA) and cracking down on illicit financial flows (IFFs) also appeared as good options to augment fiscal space in sub-groups of countries. On the ODA front, total flows to the 16 countries have grown modestly since 2014 but are expected to slightly decline on a real per capita basis over the near term. Despite the overall trend, if beneficiaries of large ODA flows, 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 could make a compelling case for more grants and concessional loans, 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 around 4 per cent above the baseline scenarios every year (Figure 2 above). Meanwhile, addressing IFFs is one of the more intriguing approaches for the region. This concerns money that is illegally earned, transferred or used that crosses borders and ultimately hinders tax revenues, including customs duties, value added taxes and income taxes. The estimated magnitude of flows is staggering in many countries, reaching as high as 20 per cent of GDP in South Africa, for example. As an illustration of fiscal space potential, if governments were able to prevent or recapture half of the estimated IFFs in a given fiscal year, effectively tax those resources by a modest 10 per cent and direct all the new revenue to the health sector, public investment in health systems would jump by more than 10 per cent on average across the 16 countries.

Lastly, borrowing and using fiscal savings do not emerge as promising fiscal space choices, outside of a few outliers. In terms of borrowing, all 16 governments have spent far beyond their means in recent years – to the tune of 5 per cent of GDP on average. This has led to extraordinary debt accumulation: general government gross debt soared from around 30 to 50 per cent of GDP between 2012 and 2018 on average. Four country studies did model this option, noting that real per child expenditure could increase by an average of 3 per cent a year above the baseline scenarios according to different borrowing arrangements (Figure 2 above). Another six countries are also expected to have manageable debt loads over the near term. However, 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. 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 natural resource exporters (such as Kenya, Mozambique, Uganda and the United Republic of Tanzania). 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 existing sovereign wealth funds could be evaluated in Angola and Botswana.

Fiscal space headwinds

Despite the opportunities, the third finding is that the fiscal space outlook is far from ideal. Every seemingly strong idea at country level must overcome a variety of challenges to both create new resources and direct them into human capital sectors. Some of the key issues are highlighted below.

- **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 (such as defence and public administration) or by helping to garner future votes through quick, visible results (such as 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. Therefore, if governments cannot work more effectively with the private sector and generate faster and more sustainable growth paths, 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.

- **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 they can involve the limited availability of skilled personnel, imperfect budget designs and plans, poor cash management practices, complex and/or non-competitive procurement processes and donor funding delays, among others. In other words, there are no easy fixes to the multitude of technical challenges.

- **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 difficult to come by for the new middle income countries in the region, as donors are committed to better targeting their aid 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.

Opportunities for UNICEF to influence the human capital investment climate

- **The fourth finding is that UNICEF can make meaningful contributions to generate fiscal space for greater investment in human capital.** The political economy analyses revealed numerous opportunities for UNICEF to more effectively engage in PFM processes and explore fiscal space opportunities. 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 national 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 areas. Such efforts can also be complemented by research and advocacy on reorienting the budget and channelling new revenue flows to support greater funding for human capital as well as highlighting the potential opportunities presented by IFFs and/or fiscal savings, where relevant. With the MoF, offices can 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 additional funding 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 designs, ensuring that they are directly linked to existing strategies and plans, support the most cost-effective interventions as well as the optimal balance of spending across service delivery levels and recurrent and capital items, and prioritize the geographic regions and population groups with the greatest needs. The weak position of social sector ministries to dialogue with the MoF was another commonly noted constraint. Here, UNICEF can leverage its partnership with the MoF to both open and support discussions with line ministries as soon as 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 and advocate for sensible reprioritization. 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 members of parliament of how the budget affects children and contributes to human capital as well as establishing 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 budget execution data, which emerges as a universal low-hanging fruit. From there, offices could begin to diagnose the underlying spending bottlenecks and identify solutions, which could be done through dedicated sections in Public Expenditure Reviews (PERs) and Public Expenditure Tracking Surveys (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. Here UNICEF can continue actively monitoring budget transparency and calling for improved practices, which most offices have done since 2017 in close partnership with the International Budget Partnership (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. Another opportunity is to work with development partners 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. Ultimately, efforts to improve budget transparency and accountability practices can help better position governments to attract greater ODA flows and borrow from international capital markets.

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 – 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.

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

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

Legend			
Low	Medium	High	NA

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.

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