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Rethinking Fiscal Policy for the Arab Region

Summary

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Foreword

In the new era of the 2030 Agenda for Sustainable Development, there is heightened emphasis on the State playing a more active role in achieving inclusive and sustainable economies and societies. Across the Arab region and around the world, this calls in part for rethinking fiscal policy. It must deliberately aim towards the kinds of smart investments in people that can unlock rapid progress across all 17 of the Agenda's Sustainable Development Goals, leaving no one behind. One starting point is a discussion around not just how much money is spent, but how it is raised and how wisely it is spent to reach short- and long-term objectives.

This report, *Rethinking Fiscal Policy for the Arab Region*, in certain ways urges a departure from conventional fiscal policy choices. For several decades, influenced by the Washington Consensus, Arab Governments have predominantly emphasized privatization and liberalization, the retreating role of the State, and the achievement of efficiencies through expenditure cuts. But given the increasingly precarious situation of many countries, solving today's development challenges requires a reassessment of accepted notions. A new direction is needed, one where economic policy closely aligns with measures to reverse the root causes of socioeconomic crisis and deepening disparities, and to equip people of all backgrounds in realizing their full potential as members of productive societies.

In asking whether or not current fiscal policies are up to the task of the 2030 Agenda and the Sustainable Development Goals, the report finds that many countries are lagging behind. Although explanations for the gaps vary, it is clear that in general, a course correction is required, connecting economic reforms, social investments and higher quality governance. Countries affected by conflict call for additional considerations, given the devastating losses they have suffered.

Fiscal policy, the report contends, can contribute to this new direction by being more consciously targeted towards restructuring economies to generate sufficient decent work, making systematic investment in high-quality human development, and using equity and sustainability as guiding principles in choices to raise and spend public resources. Managing this process will largely depend on transparent and accountable governance to set and keep rules. These must be fair and technically sound. They should be organized around a commitment to putting development on track both now and into the future.

Transformation in the Arab region will not happen automatically or overnight. But if the region hopes to be both prosperous and peaceful, transformation is an imperative. A high level of ambition and a commitment to the principles of the 2030 Agenda should guide all choices and actions on the path towards inclusion and sustainability. This report by ESCWA aims to support member States in their common quest for this vision of the future.

Mohamed Ali Alhakim

Executive Secretary of ESCWA
Under-Secretary-General of the United Nations

Contents

1. Introduction: A Course Correction

Across the Arab region, public budgets are under pressure. The reasons are many, falling oil prices and conflict among them. A number of factors relate to choices being made to raise and spend public money. In some cases, poorly designed fiscal policies have fuelled social tensions, which in turn foment demand for more spending to ease high unemployment, poverty and inequality. But in seeking to solve one problem, another has emerged: rising debt.

All governments in the region have committed to the 2030 Agenda for Sustainable Development, a vision for development that includes everyone and produces lasting benefits. Fiscal choices can determine whether or not this vision will be realized. They will define the pace of poverty reduction, the prospects for decent work, the quality of investments in health and education, and the prospects for peace, among many other outcomes.

Rethinking Fiscal Policy for the Arab Region asks whether or not current fiscal policies are up to the task of the 2030 Agenda and its 17 Sustainable Development Goals (SDGs). The report finds that the answer is mostly no—at least not yet. Many countries are lagging behind in connecting fiscal policy and development aims. Although the reasons vary across different national contexts, in general, a course correction is required in terms of economic reforms, social investments and the quality of governance. Added considerations apply to countries affected by conflict, where in some cases, decades of development have been lost.

Against the protracted and slow recovery from the 2008 global economic crisis, and experiences with fiscal stimulus in other parts of the world since then, the report urges a departure from past models of reform. For several decades, these predominantly emphasized privatization and liberalization, the retreating role of the State, and the achievement of efficiencies through expenditure cuts. But given the increasingly precarious situation of many countries in the region, solving today's development challenges requires moving in a new direction. If the region is to have a fair chance at achieving the 2030 Agenda and the SDGs, economic policy must closely align with measures to reverse root causes of socioeconomic crisis and deepening disparities.

In this, fiscal policy should have a prominent role. It should be consciously aimed towards restructuring economies to generate sufficient decent work, making systematic investment in high-quality human development, and using equity and sustainability as guiding principles in choices to raise and spend public resources. Managing this course correction will largely depend on transparent and accountable governance. It must set and keep rules that are both fair and technically sound, and organized around a commitment to putting development on track for the short and longer term.

Assessing a region of sharp contrasts

Analysis in this report classifies Arab countries in three categories, given sharp contrasts in revenue sources and development challenges. The categories comprise the oil-rich high- and middle-income countries (subsequently referred to as the oil-rich countries), the oil-poor middle-income countries (subsequently referred to as the oil-poor countries) and low-income countries.

The oil-rich countries include Algeria, Bahrain, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia and the United Arab Emirates. Bahrain and Oman have much larger fiscal constraints than Qatar or the United Arab Emirates, but one common element is reliance on revenues from oil and gas. While they have larger buffers for meeting development needs, revenues are susceptible to oil-price fluctuations, as witnessed during the recent plunge in prices.

The oil-poor countries encompass Egypt, Jordan, Lebanon, Morocco, the State of Palestine, the Syrian Arab Republic and Tunisia. They rely on mixed sources of revenue, but mainly taxation. For a variety of reasons, tax rates are low compared with the size of these economies. They face severe constraints in finding enough financing to close development deficits such as high youth unemployment, increasing poverty and the lack of adequate social protection.

The low-income countries comprise Comoros, Djibouti, Mauritania, Somalia, the Sudan and Yemen. They have high levels of poverty and significant development challenges as well as severely constrained fiscal space.

Countries affected by conflict—namely, Iraq, Libya, the Syrian Arab Republic and Yemen—fall in each of the three country clusters. Their situation is beyond the reach of regular fiscal frameworks, since their urgent priority is to restore destroyed infrastructure, regain capital, and build productive capacity for economic diversification and social stability. The report therefore provides specific analysis for these countries.

2. A Region Risks Missing the Road to the SDGs

Fiscal policy can be a powerful instrument when properly applied. In the Arab region, it is not being used to help put countries on the right track to achieving the 2030 Agenda and the SDGs. Low productivity growth, human development losses, debt burdens and poor fiscal management are among the factors limiting progress—and requiring urgent attention.

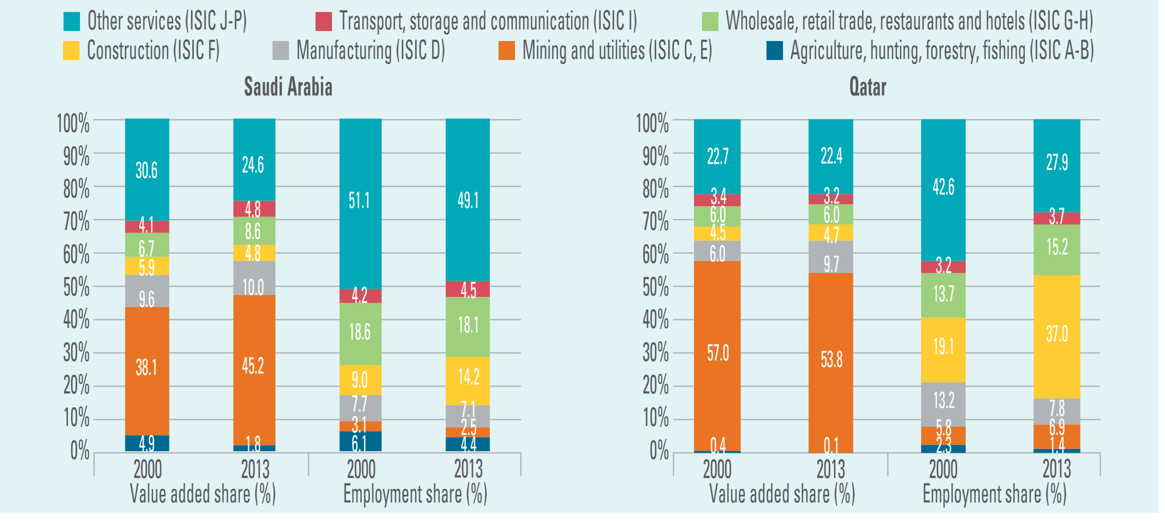
A. Structural transformation has not yielded enough decent work

Inclusive, sustainable development depends on economies being structured to achieve high productivity, deliver decent work that is widely available and practice the careful stewardship of natural resources. Arab economies mostly fall short on these measures.

While structural changes have taken place in the economies of both oil-rich and oil-poor countries, they have yielded mainly informal, poorly paid jobs. As a result, productivity has barely budged, economic growth has been sluggish and benefits have been unevenly shared. Fiscal policy has not been used to guide strategic investments, from infrastructure to education to innovation, that can unlock the kind of structural transformation envisioned in the 2030 Agenda.

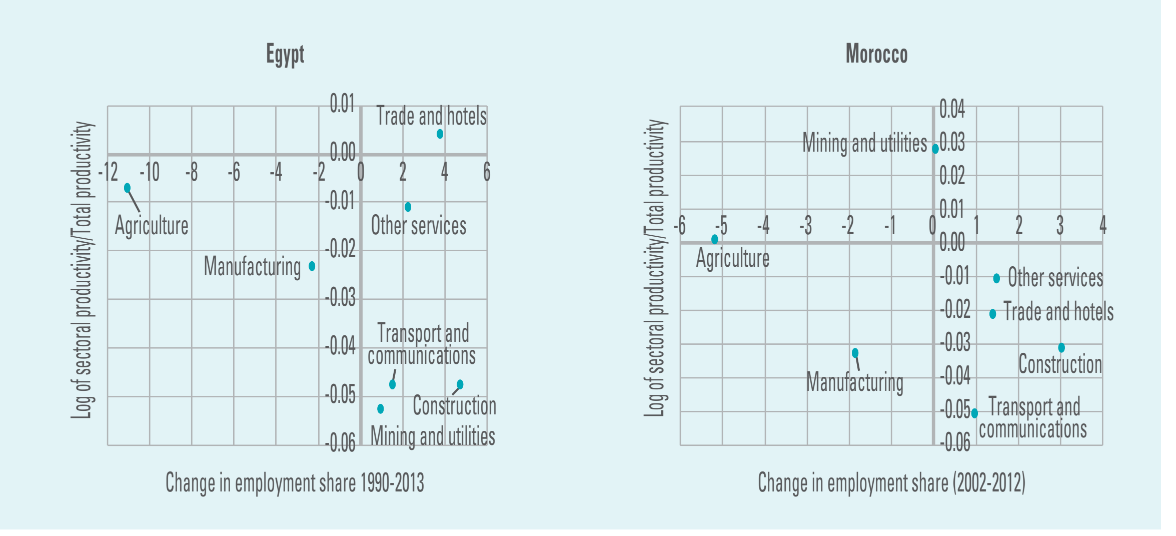
In oil-rich countries like Oman, Qatar and Saudi Arabia, mining and utilities make significant contributions to the economy at large, but provide only a small share of employment. Outside the oil industry, which skews largely towards construction, hotels and restaurants, financial services and "other services," job opportunities are more diverse, but mainly absorb low-skilled, cheap labour from Asia (figure 1).

Figure 1 Changing economic structures have not led to higher-end manufacturing or services in oil-rich countries



Source: Authors' calculations, based on data from the National Accounts Main Aggregates Database of the United Nations and Key Indicators of the Labour Market of the International Labour Organization (ILO).

Figure 2 In oil-poor countries, changing employment shares have brought a retreat in productivity and an increase in informal jobs



Source: Authors' calculations, based on data from the National Accounts Main Aggregates Database of the United Nations and Key Indicators of the Labour Market of ILO.
Note: The period of analysis for each country depended upon continuous years of data availability.

In oil-poor countries such as Egypt and Morocco, people have moved into work in new sectors, leaving farms for service jobs, for example, but productivity has declined. Most new employment is informal, poorly paid and low in productivity. A worrisome decline in higher-end manufacturing jobs indicates a concentration of largely lower-end industries, such as textiles and food businesses (figure 2).

The oil-rich countries, particularly the Gulf Cooperation Council (GCC) countries, have invested a relatively high share of total public expenditure in capital investments, such as improved infrastructure. But this has not contributed significantly to developing higher productivity sectors outside oil. Further, by bringing in large numbers of low-skilled migrant workers, mainly for services related to construction and the hotel industry, labour policies have discouraged investment in advanced education and competitiveness, segmented the labour market, and reduced the pool of people who might invigorate new industries or launch innovations as entrepreneurs.

The oil-poor countries suffer from serious infrastructure deficiencies in part due to constraints on public spending, but expenditure has also tended to favour subsidies and consumption, public sector salaries, interest payments, military costs and so on, rather than investment in economic diversification. Oil-poor countries have improved human capital through historic investment in education, yet contend with the problem that many well-educated people cannot find employment that matches their skills.

Across the region, inadequate investment in quality education and research and development remains a major challenge. Compared with the rest of the world, the region has a poor record of association between research and development expenditure and growth of gross domestic product (GDP).

Structural change for its own sake is not enough; it must be the right kind, occurring at the right pace. To make it transformative, fiscal policy needs to guide investments towards economic diversification and competitiveness, within a framework of inclusion and sustainability. Fiscal choices also need to work in tandem with other policy reforms, including those related to industry, trade, employment and exchange rates.

B. Investment in human development is inadequate

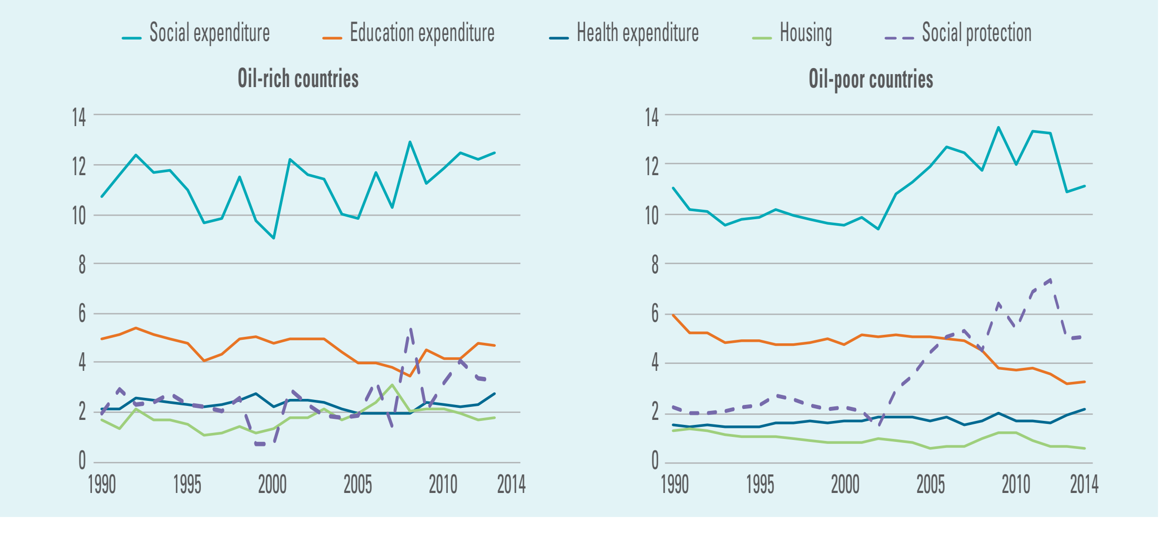
Since 2008, the Arab region has seen major swings in social expenditure. For the most part, spending on education and health remains too low. Reforms to expand and better target social investments will be essential to move towards more inclusive and stable societies and economies, and are now particularly critical given rising poverty and exclusion.

The consequences of current fiscal choices have included high reliance on out-of-pocket expenditure for health services, which has severe impacts on the poor and even members of the middle class. Broader economic impacts have encompassed human capital losses when people do not have adequate health and education to realize their full productive potential in the workforce and elsewhere. Countries using discretionary spending to compensate for spending deficits in the short term, without the clear application of fiscal rules, have faced destabilizing effects such as higher debt burdens.

Starting in 2005, oil-rich countries increased public spending as a share of GDP, taking advantage of greater revenues from rising oil prices. On average, the share increased from 28 per cent in 2005 to 50 per cent in 2014. An upsurge from 2011 to 2012 for increased public salaries and benefits was a reaction to the spread of discontent during the Arab uprisings. But by 2014 and beyond, sharply falling oil prices meant that oil-rich countries were finding it difficult to maintain high levels of public expenditure.

In oil-poor countries, uncertainties in public expenditure have been more apparent over time. A slight increase in spending as a share

Figure 3 Social spending has declined as public budgets have contracted (percentage of GDP)



Source: N. Sarangi and J. von Bonin (2017). Fiscal Policy on Public Social Spending and Human Development in Arab Countries. ESCWA Working Paper. E/ESCWA/EDID/2017.WP.13.

of GDP from 27 per cent in 2005 to 30 per cent in 2014 was followed by a drop to 28 per cent by 2015. The increase was partly due to the rise in oil subsidies linked to climbing oil prices. In addition, the 2011 protests compelled discretionary increases in public spending despite declining economic growth. Fiscal deficits rose as a result, and by 2014 and 2015, most of these countries had to adopt fiscal adjustment programmes that emphasized cutting expenditure.

In both oil-rich and oil-poor countries, public social expenditure, as a share of GDP, is only a little over half of the average in countries in the Organisation for Economic Co-operation and Development (OECD). A slightly rising share in oil-poor countries from the mid-2000s until 2014 was largely due to increased spending on oil subsidies rather than on education or health. Average expenditure on education, as a share of GDP, registered a noticeable continuous decline from around 5 per cent in 2007 to 3 per cent in 2014 (figure 3). Average health expenditure remained stagnant between 2000 and 2014, at around 2 per cent. In OECD countries, health and education expenditure shares accounted for 6 per cent and 5 per cent of GDP, respectively, in 2013.

Stagnating and declining trends in housing expenditure in the region are a particular concern given rapidly increasing urbanization and the fact that deprivation in living conditions often drives poverty. Average expenditure as a share of GDP for oil-rich countries was relatively stagnant at around 2 per cent from 1990 to 2014. In oil-poor countries, the share declined from 1.3 per cent to 0.6 per cent.

Average expenditure on social protection as a share of GDP slightly increased from 2 per cent to 3 per cent in oil-rich countries between 2005 and 2014, and rose from 3 per cent to 5 per cent in oil-poor countries. Yet programmes suffer from poor targeting and fragmented social assistance expenditures. In many cases, subsidies have been at the core of social protection systems, dominated by energy subsidies that primarily benefit middle- and high-income groups, since they consume much more than the poor. Changing population dynamics and rapid ageing along with high unemployment and poverty are expected to put further stress on social protection expenditure needs in the future.

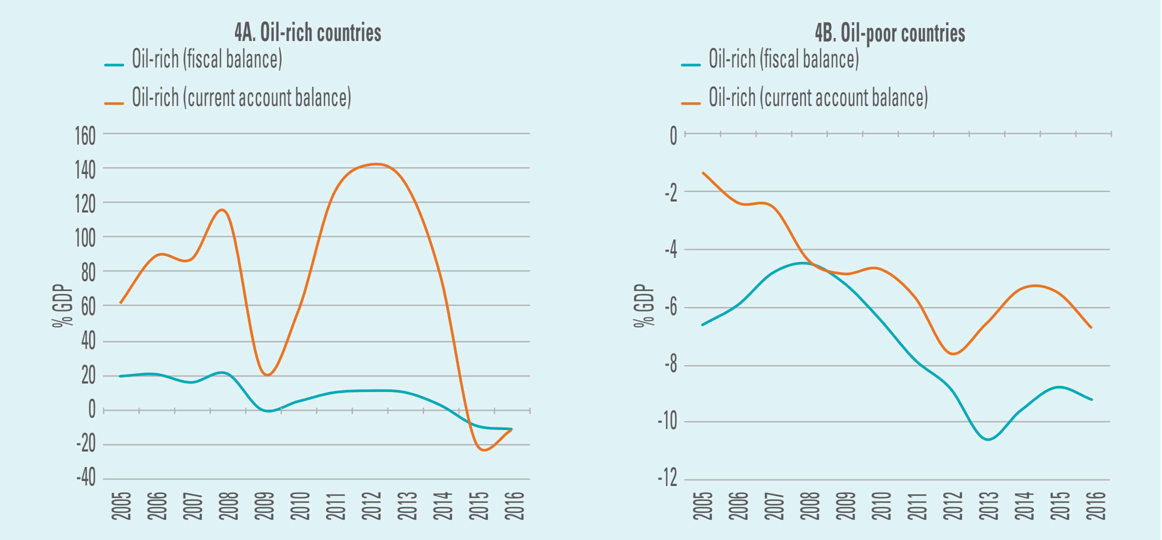
C. Public debt is unsustainably high, tax revenues are not high enough

Room to manoeuvre in public budgets to support economic and social investments diverges significantly across the three clusters of countries. The oil-poor and low-income countries have major constraints, while the oil-rich countries are relatively better off. Both face issues related to raising revenues, including relatively low rates of taxation. A further issue for the oil-poor and low-income countries is a rising level of debt.

After more than a decade of declining public debt, a reversal occurred in 2008 in the oil-poor countries as they suffered the brunt of the global economic crisis. By 2016, debt had skyrocketed as a share of GDP, particularly in Lebanon, where it reached 143 per cent. Jordan touched 95 per cent, and Egypt, 97 per cent.

Underscoring a lax approach to fiscal policy, temporary increases in government expenditures have driven fiscal deficits and debt. Fiscal deficits increased from around 4 per cent to 9 per cent of GDP from 2008 to 2016. Further concerns have arisen from the deterioration of the current account deficit, financed through borrowing in foreign currency. On average, the current account deficit of oil-poor middle-income countries increased from 4 per cent to about 7 per cent of GDP over the same period (figure 4).

Figure 4 Both fiscal and current account balances show worsening trends in oil-rich and oil-poor countries



Source: N. Sarangi and L. El-Ahmadieh (2017). Fiscal Policy Response to Public Debt in the Arab Region. ESCWA Working Paper. E/ESCWA/EDID/2017/WP.6.

In several of the oil-poor middle-income countries, namely, Egypt, Jordan and Tunisia, debt is rising but interest rates are still below economic growth rates, implying that debt ratios can be stabilized. This depends on coordination with monetary policy to manage interest rates and continued growth in the economy, which can draw in part on investments in productivity and human capital guided by well-managed fiscal policy. In its World Economic Outlook in 2015, the IMF underscored that debt-financed public investment in infrastructure, education, health and social protection could boost aggregate demand and productivity.

Currently, however, IMF projections and recommendations for improving fiscal sustainability focus mainly on significant cuts to public expenditures in the next five years. In developing economies, where private sector investment is not easy to crowd in, this can lead to economic contraction and low growth in employment, and diminish social services and safety nets, aggravating development gaps. Towards realizing the promise of the 2030 Agenda and the SDGs, policy choices need to correspond not primarily to accepted doctrines, but to evidence of the results on the economy and human development.

Across the Arab region, other issues arise from paying insufficient attention to mobilizing domestic resources, a major challenge, but a measure essential for increasing investment in human capital, and realizing more inclusive and sustainable economies. A taxation system rooted in principles of effectiveness as well as equity can help in correcting development gaps, including through raising revenues for pro-poor initiatives. The rationale for tax reforms is clear from a simple tax buoyancy calculation, which indicates that GDP growth alone will mostly not spur a proportional jump in revenues.

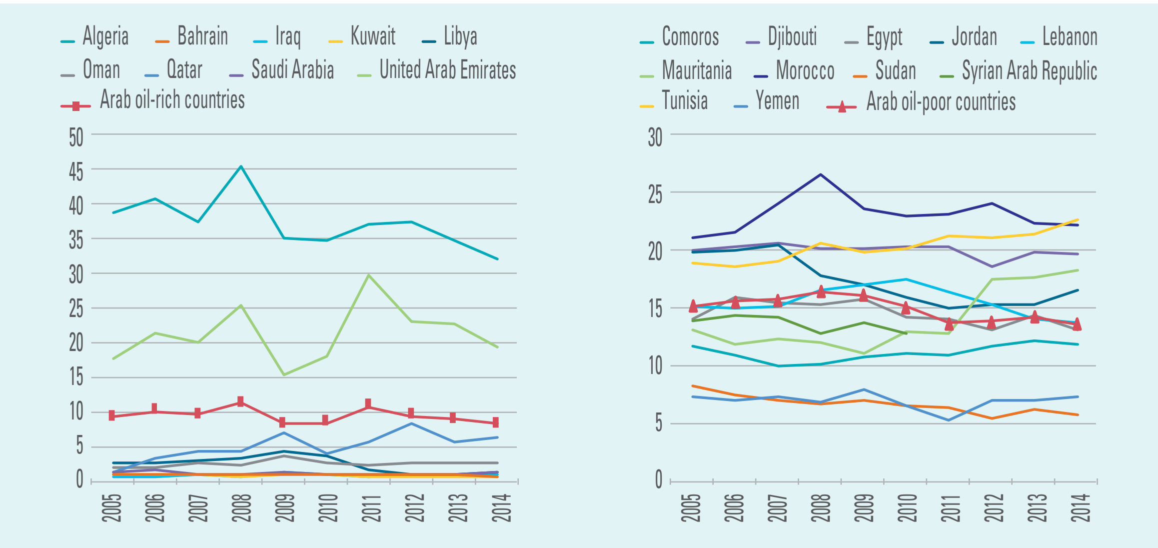
The current low ratio of taxes to GDP in most countries in the Arab region reflects so-called “rentier” economies and low-quality governance. GCC countries, for example, do not impose a personal income tax, and even corporate taxation is mostly negligible, except in the United Arab Emirates. The tax component of total revenue as a percentage of GDP varied from as little as 1 per cent in Kuwait to 6 per cent in Qatar in 2014 (figure 5). The United Arab Emirates is an exception with taxes at 20 per cent of GDP in 2014, mainly drawn from real estate and a high corporate income tax rate of 55 per cent on companies and financial institutions that operate in the banking and oil and gas sectors. Among the non-GCC oil-rich countries, Algeria has a higher share of taxes to GDP, owing to diversified sources of taxes, including a value added tax (VAT) and a considerably high corporate income tax.

Taxes constitute a major source of revenue in the oil-poor countries, but the share of GDP is still much lower than the 20 per cent average for countries at similar levels of development. Most oil-poor countries have shares between 10 per cent and 20 per cent, except for Morocco and Tunisia, both at around 23 per cent in 2014. In the Sudan and Yemen, the share is very low, at 6 per cent and 7 per cent, respectively. Trends in the share have been largely stagnant.

Indirect taxes, like those on goods and services, constitute the major share of taxation in oil-poor countries, with the share increasing in some over time. This pattern is regressive, since the middle class and the poor bear a higher burden than the rich. In Jordan, indirect taxes constituted around 71 per cent of total tax revenue in 2014 (figure 6). Jordan and Morocco showed an increasing share of indirect taxes in total tax revenue between 2005 and 2014. Current tax reforms in several countries, such as Egypt, Lebanon and in the GCC, have put greater emphasis on VAT to raise resources.

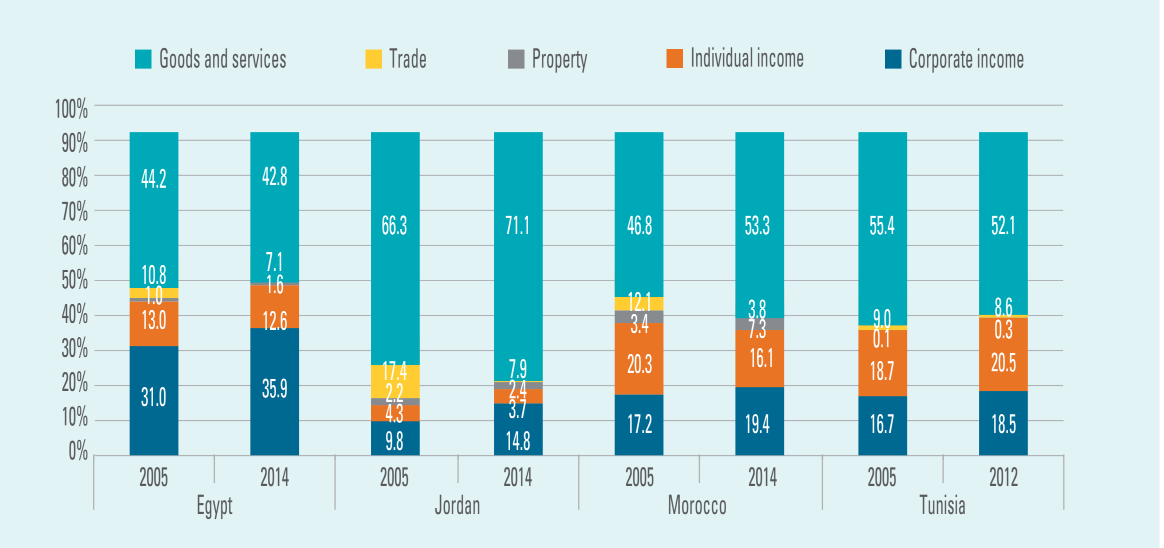
By contrast, the share of income tax in total tax revenue in Egypt, Jordan and Morocco remained either stagnant or declined between 2005 and 2014. In Tunisia, the share saw some improvement during the same period. Both Morocco and Tunisia have recently undertaken some progressive income tax reforms.

Figure 5 Tax revenues as a share of GDP are relatively low



Source: N. Sarangi (2016). Domestic Public Resources in the Arab Region: Where Do We Stand?. ESCWA Working Paper. E/ESCWA/EDID/2017/WP.1.

Figure 6 Taxation in oil-poor countries is predominantly on goods and services, imposing a greater burden on the poor and middle-class



Source: N. Sarangi (2016). Domestic Public Resources in the Arab Region: Where Do We Stand?. ESCWA Working Paper. E/ESCWA/EDID/2017/WP.1.

A wealth tax, imposed on property, capital gains and so on, constitutes a negligible share of tax revenues in most countries, even though this kind of tax is considered more progressive and equitable. Among the four countries in figure 6, Morocco has a relatively higher share of earnings from a property tax, which increased from 3.5 per cent of tax revenue in 2005 to 7.4 per cent in 2014. In Egypt, the property tax share increased meagerly from 1 per cent in 2005 to 1.6 per cent in 2014, despite evidence of increasing inequality. Globally, taxes on property form around 7 per cent of total tax revenue, much higher than in Arab countries.

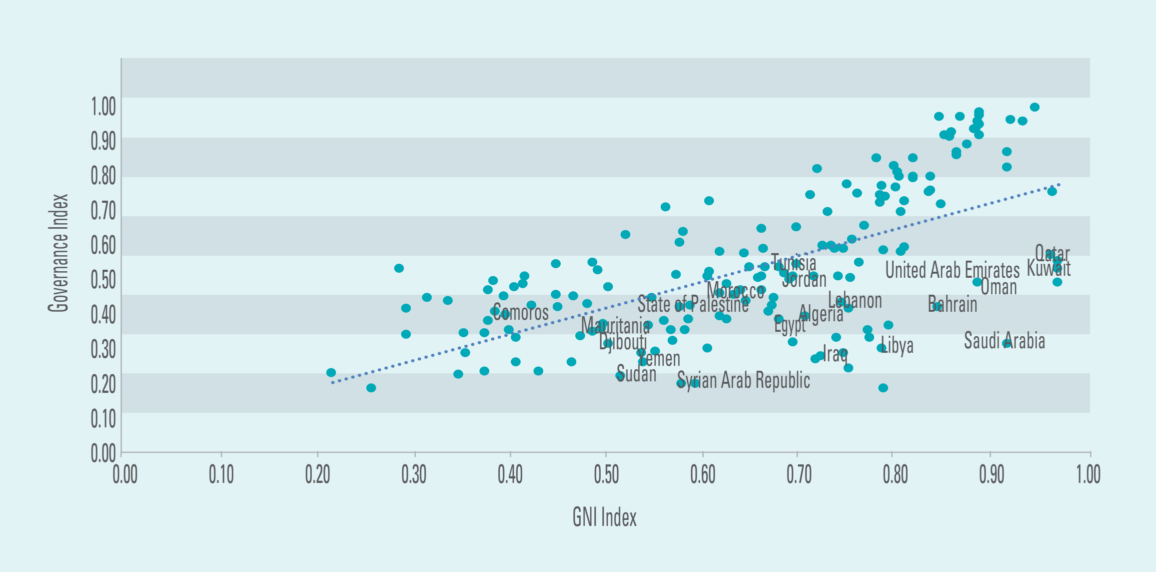
D. Governance deficits weaken fiscal discipline and erode resilience to economic shocks

Fiscal policy both influences and manifests governance dynamics. As a general rule, public spending makes a greater difference in countries with better quality governance. Poor governance, where institutions are weak and fiscal rules are inconsistently applied, adversely affects equity and efficiency in choices to spend and raise revenues.

On average, the quality of governance in Arab countries has deteriorated over the last two decades, to varying degrees. Compared to average global scores on the Governance Index, measured by a composite index of voice and accountability, and rule of law, the oil-rich countries score poorly (figure 7). Oil-poor middle-income countries, such as Jordan, Morocco and Tunisia, are closer to the expected global average despite lower income.

When Governance Index scores are factored into a calculation of the Human Development Index, which also considers income, health and education, all Arab countries suffer losses in their human development score. Some countries, such as Iraq, Saudi Arabia, the Sudan and the Syrian Arab Republic, lose more than a fifth of their score.

Figure 7 In the Arab region, greater wealth has not meant better governance (All countries, 2013)



Source: K. Abu-Ismail, A. Kuncic and N. Sarangi (2016). Governance-adjusted Human Development Index: The case for a broader index and its implications for Arab States. ESCWA Working Paper. E/ESCWA/EDID/2016/WP3.

The quality of governance influences several trends in expenditure and revenue mobilization. In oil-poor countries, those ranking better on control of corruption, government effectiveness and political stability spend more on social investments. They have a higher share of taxes in total revenues. In oil-rich countries, the link between social spending and governance indicators is less straightforward.

While various governance factors affect public finances, the quality of institutions is particularly important. Countries with well-functioning institutions may plan and deliver better in the face of fiscal adjustments. They tend to have a clearer understanding of fiscal positions, including at the onset of a crisis, and produce more accurate macroeconomic forecasts.

One critical element is the ability to strike a balance between the application of fiscal rules and the flexibility to manage temporary shocks. If weak checks and balances limit controls on discretionary spending, prospects dim for systematically investing in structural transformation and human development over time—and across the cycles of an economy.

Integral to better quality governance is ensuring that fiscal policy choices inclusively respond to the rights and needs of different population groups. While women make profound contributions to economies and societies, the share of public expenditure devoted to advancing gender equality often falls short in the region, whether the issue is adequate reproductive health care or services that reduce the burden of women's unpaid work. Taxation may also embed gender biases, as in cases where it targets commodities and services consumed primarily by women and girls. Tax reform needs to aim at being more progressive in general, and alert to avoiding potential gender biases in particular, in both direct and indirect taxation.

E. Conflict takes a toll—recovery presents an opportunity

Conflict has had devastating effects on development in the Arab region, as well as on public revenues. Between 2011 and 2015, conflicts led to a net economic loss of $613.8 billion, equivalent to 6 per cent of the region's GDP. The total would surge further by adding in capital flights, foregone investments, loss of remittances, loss of earnings by workers and reduced trade volumes. Human development losses have been enormous as well.

Iraq and Libya, where public revenues come mostly from oil, incurred the largest revenue losses between 2010 and 2015, estimated at $47 billion and $83.5 billion, respectively. These sums are still mounting, exacerbated by continued conflict and instability, and falling oil prices.

Revenue losses for the Syrian Arab Republic and Yemen between 2010 and 2015, mainly related to a mix of falling tax and natural resource revenues, were estimated at $27.5 billion and $51.6 billion, respectively. The revenues of the Syrian Arab Republic tumbled starting in 2011 due to the drop in economic activity and the dominance of extremist groups over oil production in Dair el Zor. Yemen's revenue deterioration resulted from maturing oil fields and the sabotage of new oil explorations.

Post-conflict, these countries face enormous challenges, yet there are also opportunities, some of which stem from well-coordinated fiscal and macroeconomic policy choices, and an early commitment to working towards the 2030 Agenda and the SDGs. These choices can, for example, allow some degree of inflationary pressure to boost investment and consumption. They can seek to direct financing flows towards human capital investments and sectors of the economy most likely to boost productivity and provide decent work, while keeping exchange rates competitive. The specific balance will vary by country, but a core principle is to consider the integration of policies across multiple dimensions, aiming for inclusion as a matter of development and peace, and avoiding the tendency to focus solely on economic growth.

3. Rethinking Fiscal Policy

While the Arab region faces complex challenges, fiscal policy offers many of the tools to resolve these. This report proposes several primary considerations. Taken together, they build on the understanding that fiscal policy is crucial to economic reforms and social investments required to attain more inclusive and sustainable development. Equally critical are governance reforms and political stability to guide policy towards those ends.

In looking towards the future imagined by the 2030 Agenda and the SDGs, one to which people across the region aspire, the report argues for the following changes:

Design fiscal policies to promote economic transformation and decent work: Transforming the current pattern of poor-quality growth lies in boosting public investment in two strategic areas. The first entails encouraging economic sectors that add significant value to the economy and have strong potential to generate decent work, such as higher-end services and industry. The second involves concerted investments in innovation, human capital and infrastructure that contribute to greater productivity. Overall, this process needs to be geared towards crowding-in private investment. Complementarities with monetary, trade, industrial, and environment and climate policies can accelerate the pace of transformation and ensure it is sustained over time.

In oil-rich countries, which have larger fiscal space, including sovereign wealth funds, a well-designed fiscal policy can diversify investment to modern strategic sectors and also manage loss of revenues stemming from commodity price volatility. Appropriate fiscal incentives prompting diversification along with the advancement of higher education and competitiveness in occupational choices can improve employment prospects and boost productivity.

In oil-poor countries, governments need to reconsider fiscal policy decisions and coordination with industrial policy in investing in higher-productivity sectors, infrastructure, human capital and research and innovation. Since creating a healthy fiscal space is a bigger challenge, setting and enforcing appropriate fiscal rules to support financing for any permanent increase in expenditure will be crucial.

Make budget choices to reduce poverty and inequality, and close health, housing and education deficits: An important starting point is to set and implement rules for public expenditure aimed at advancing inclusive and sustainable development. Scaled-up investments are urgently needed in crucial areas of human development, including health, housing and education. In education, for instance, the region could catch up to the world average in mean years of schooling by increasing public education spending by 1 per cent of GDP over the next six years. This would be readily affordable through shifts away from fuel subsidies as well as military expenditures. It would contribute not only to human capital, but also to renewing a frayed social contract, caused in part by the lack of social and economic mobility.

Expand and sustain fiscal space by raising revenues: In most countries, a stronger focus should be put on mobilizing revenues through taxation, including through moving away from regressive measures such as high and increasing reliance on taxes on goods and services. More progressive taxation could deliver multiple benefits, propelling economic reforms and human capital investments, lessening inequalities and shielding revenue streams from shocks such as oil price fluctuations. The compulsory filing of tax returns, even for those in lower income categories who would likely be exempt from taxation, would help to move the informal sector towards formal sector recognition, and increase access to essential public services and benefits among the poor in particular.

Oil-poor countries in particular should consider instituting fair tax systems that correct some of the inequalities in their societies, and taking administrative reforms to control tax evasion, tax avoidance and illicit financial flows. A global standard needs to be adopted to enforce information exchange among different government entities to tackle illicit financial flows. Oil-rich countries should consider diversifying revenue sources to cope with managing volatility. This can improve their fiscal stance, strengthen macroeconomic stability and support increased social investments, all of which have gained even greater importance amid forecasts for continued low oil prices.

Harness public expenditure management for inclusive and sustainable development through better quality governance: Consequences of weak checks and balances, and inadequate budgeting and planning institutions in the region are the skewed allocation of resources, and the lack of consistent links between fiscal choices and development aims. Institutions need to be equipped to deliver on fiscal adjustments, and devise and implement credible fiscal plans. Data, as an essential planning tool, could be better geared towards accurate, comprehensive estimates of social spending. Effective fiscal rules, accompanied by short-, medium- and long-term objectives, are a particular priority in countries facing dangerous levels of debt.

Orient fiscal policy towards peace and development in post-conflict countries: Post-conflict settlements that establish new political and economic institutions can bridge peace and development in part by defining the scope of fiscal management. This needs to cover both raising and spending of resources, given how mismanagement of resources can make societies prone to relapsing into conflict. Well-defined fiscal rules, protected by law, should guide an emphasis on reconstruction as well as investments in human development and an inclusive economy and society.

While a stable flow of international aid, from external sources, may be required, it may also be appropriate to look to domestic resource mobilization, including through progressive taxation. In countries rich in natural resources, as pressing reconstruction and development priorities are met, excess resources can be invested in a sovereign wealth fund until they can be absorbed.

Regaining the path to sustainable development

The new era of the 2030 Agenda and the SDGs ushered in a renewed emphasis on the role of the State in steering economic and social transformation that is fully inclusive and sustainable. Agreed in the wake of the 2008 economic crisis, with its effects still rippling across the Arab region today, the Agenda was in part a call for countries around the world to rethink fiscal policy.

The Arab region has followed past models of pro-market economic policymaking, adopted from the Washington Consensus. At the same time, it has attempted to maintain a social contract premised on providing essential services to its peoples. This often contradictory combination has now reached a breaking point. Economic models need to be reoriented to deliver not just greater efficiencies, but human development that leaves no one behind. Only vibrant and productive economies can underpin a new social contract that provides everyone with the full range of capabilities and opportunities needed to thrive.

The region can learn from its own past experience and from those elsewhere in using fiscal policy to address key concerns, such as investing in industrial development; advancing education, research and innovation; providing social protection; and mobilizing revenues, taking into account equity and justice in taxation systems. The new industrial strategy of the United Kingdom, released in November 2017, is one recent example of a State reimagining its role and the use of fiscal policy to realize a more productive, inclusive economy and society.

Transformation in the Arab region will not happen automatically or overnight. But if the vision is to achieve the 2030 Agenda and the SDGs, and a region that is both prosperous and peaceful, transformation is no longer an option. It is an imperative, one that should guide all choices and actions to regain the path to sustainable development.