International Policy Centre for Inclusive Growth

The International Policy Centre for Inclusive Growth is jointly supported by the Poverty Practice, Bureau for Development Policy, UNDP and the Government of Brazil.

One pager No. 136

February, 2012

Fiscal Space in the Arab Countries

by Khalid Abu-Ismail, UNDP; Rathin Roy and Raquel Almeida Ramos,
International Policy Centre for Inclusive Growth (IPC-IG)

The paper on which this One Pager is based (Roy, Abu-Ismail and Ramos, 2011) suggests concrete policy options which would create the fiscal space needed for structural transformation. After analysing the fiscal constraints faced by different countries and country groupings in the region, the paper suggests policies to increase fiscal space for the development transformation needed by expanding the fiscal base and fostering changes in the *sources* of revenue. The paper seeks to identify policies that improve the equity and progressivity of fiscal incidence.

Fiscal space in the Arabic region differs considerably among the countries, varying according to income levels and to whether the country is an oil exporter or importer. **Oil exporters** that do not belong to the low-income group, such as the Gulf countries plus Libya and Algeria, do not have a problem of fiscal space. These countries are also more advanced regarding the Millennium Development Goals. The main issue for them is not the availability of resources, but the need to choose and to adopt appropriate policies for economic diversification.

Lower-income oil exporters such as Yemen and Sudan are in a more precarious position. Yemen is in a particularly undesirable position: it faces a decline in oil reserves, which, given the recent rise in food prices, may worsen poverty. Although the country has some room for debt financing, it is quite marginal compared to the resources required. In this scenario, Official Development Assistance (ODA) will be needed to support the Yemeni economy in the short or medium term. Sudan is in a relatively more comfortable situation *vis-à-vis* the need for ODA, due to the prospect of better use of oil revenues and the potential of the agricultural sector. Still, a significant scale-up of public investment will be necessary.

In **oil-importer** countries such as Egypt, Syria, Morocco, Jordan, Lebanon and Tunisia, fiscal space will have to be managed with care. The latter three are in a more comfortable situation, and the fiscal space constraint is less binding: their economies can count on tourism, transfers and remittances, and they have smaller populations and larger per capita GDP—although Lebanon's high debt-to-GDP ratio places it as a distinct outlier, creating historic difficulties.

In the case of Syria, Morocco and Egypt, however, the fiscal challenge is a priority. Egypt and Syria are in particularly difficult situations.

Tax Revenue (% of GDP), 2007–2010

Country	2007	2008	2009	2010
Algeria	8.1	8.7	11.2	11.4
Djibouti	20.4	18.4	18.6	19.1
Egypt	15.4	15.7	12.4	14.9
Lebanon	14.8	16.5	17.4	18.4
Libya	2.9	3.1	5.6	5.0
Morocco	24.8	25.5	25.9	26.1
Sudan	6.9	6.2	-	-
Syria	10.9	8.4	12.2	11.6
Tunisia	20.8	-	-	-
Yemen	7.3	7.1	7.4	7.8
Average	**13.2**	**12.2**	**13.8**	**14.3**

Source: IMF, WEO.

Egypt relies on declining oil revenues, and Syria's space for increasing internal debt financing is relatively constrained. The solution to these countries' fiscal problem will be contingent on a) their ability to find the right set of policies other than ODA that would maximise fiscal space, *and* b) their ability to further diversify their economic bases.

Based on the analysis of the fiscal situation in the region, the paper has different recommendations for the diverse groups of countries. For those with higher income levels or that are oil exporters—such as Tunisia, Jordan, Lebanon, Algeria, Libya and the Gulf countries—the focus of fiscal policy should be on its *stabilisation* and *allocation* roles. The countries with the lowest income levels face a different scenario, where the challenge of fiscal policy is to finance a permanent increase in public investments to secure the agreed development goals. In this context, the priorities are the use of the *growth* and *allocation* functions of fiscal policy. Lastly, policy recommendations for Egypt, Syria and Morocco are more mixed, as they possess features of both scenarios.

Reference:

Roy, R., Abu-Ismail, K. and Ramos, A. R. (2011). *"Is there Fiscal Space for Financing an Arab Development Transformation?" IPC-IG Working Paper No. 88*. Brasília. IPC-IG.

International Policy Centre for Inclusive Growth (IPC - IG)
Poverty Practice, Bureau for Development Policy, UNDP
Esplanada dos Ministérios, Bloco O, 7º andar
70052-900 Brasilia, DF - Brazil

E-mail: ipc@ipc-undp.org ▪ URL: www.ipc-undp.org
Telephone: +55 61 2105 5000