

Limited fiscal space puts the Arab region recovery from COVID-19 at risk




Shared Prosperity Dignified Life



Introduction

Governments worldwide have announced fiscal stimulus packages amounting to \$9.6 trillion, which includes about \$100 billion in the Arab region, to fight the severe health and economic impacts of COVID-19. However, there are significant differences in stimulus packages between the developed and the developing countries. With limited fiscal space, the low- and middle-income countries face greater risks of meeting expenditure needs to recover better and mitigate the impact of COVID-19.

Assessment of COVID-19 stimulus responses: the world compared to the Arab region

 Globally, Governments have announced about \$9.6 trillion in fiscal stimulus packages to fight the negative impacts of



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COVID-19 on lives and livelihoods. In the Arab region, all the government fiscal stimulus plans taken together amount to about \$102 billion, which is nearly 1 per cent of total global fiscal stimulus (figure 1). Government fiscal stimulus packages are mainly in the form of financial support to expand social protection and soft loans to individuals and businesses adversely affected by the COVID-19 pandemic.

In addition to fiscal stimulus, central banks worldwide have announced liquidity enhancement measures by about \$4.9 trillion, mostly from the United States and European central banks (figure 1). The injection of liquidity is being done mainly through measures such as reducing interest rates, purchasing assets and introducing foreign currency swap lines. Central banks in the Arab region have expanded liquidity support in the amount of about \$140 billion, which is nearly 3 per cent of global liquidity support.

The average government fiscal stimulus of the Arab region, as a share of regional gross domestic product (GDP), is nearly 4 per cent, which is less than half the global average fiscal stimulus of 11 per cent of GDP. Among the regions globally, the fiscal stimulus in Europe and Central Asia is at the top, with about \$3.9 trillion, which is 17.6 per cent of their GDP (figure 2). In addition, on 27 May, the European Commission announced the creation of a new recovery instrument called the “Next Generation EU” of about 750 billion euros to support European Union member States with investments, reforms and incentivizing private investments. In North America, the fiscal stimulus of the United States and Canada is the second highest relative to their GDP (13.7 per cent). A major share of their stimulus is the \$3 trillion package in the United States, which is the single largest stimulus by any country in total value. Excluding North America and Europe, the average fiscal stimulus of the developing regions is about 6.3 per cent of GDP. The Sub-Saharan African region is at the bottom with a fiscal stimulus of only about 10 billion or 0.6 per cent of their GDP.

The fiscal stimulus of developing countries and the least developed countries (LDCs) is significantly lower than that of the developed countries, which puts their recovery from the global pandemic at risk. The fiscal stimulus of G7 countries taken together is about a massive \$7.3 trillion, which is 75 per cent of the global fiscal stimulus. As a share of their GDP, the stimulus is above 18 per cent. Other countries taken together have announced about \$2.3 trillion, which is at an average of 5 per cent of their GDP. The difference in stimulus announcement between developed and developing countries is apparent.

European countries dominate among the top 10 fiscal stimulus packages globally, relative to their GDP. The top three countries are Italy (43 per cent), Germany (34 per cent) and Sweden (28 per cent). France ranks tenth and the United Kingdom is near, ranking eleventh. Among Asian giants, Japan (fourth) and Malaysia (seventh) are in the global top 10 list of large fiscal stimulus, relative to their GDP. The United States ranks sixteenth in terms of percentage, although it is the highest in terms of value of fiscal stimulus.

Figure 1. Global stimulus to mitigate the impact of COVID-19

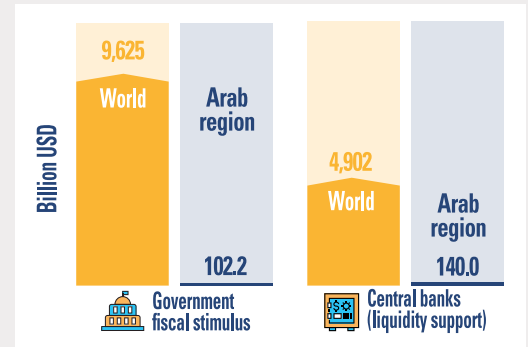


Figure 2. Government fiscal stimulus across regions (% GDP)

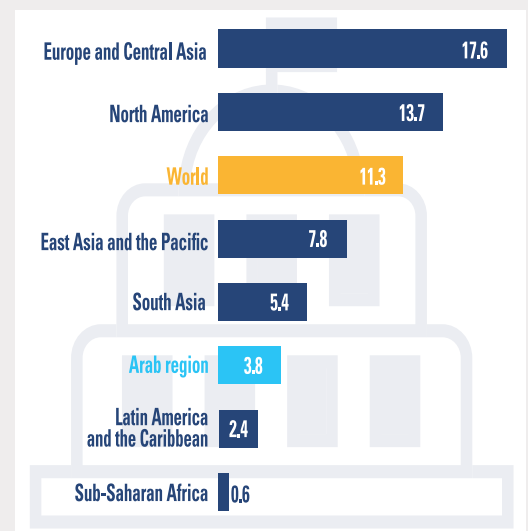
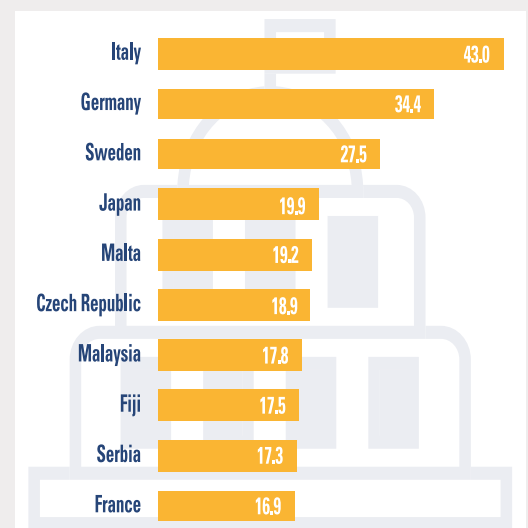


Figure 3. Government fiscal stimulus (% GDP): top 10 countries



In the Arab region, five out of the top 10 fiscal stimulus announcements, relative to their GDP, are from GCC countries.

The GCC countries together account for about \$80 billion, which is 78 per cent of the total government stimulus of the Arab region. Mauritania announced about \$670 million in stimulus, mainly for the creation of a solidarity fund to fight COVID-19. Although the amount is small in value, it is about 12 per cent of Mauritania's GDP, which ranks this LDC at the top of the list of fiscal stimulus efforts in the region relative to GDP (figure 4). Qatar ranks second and the Sudan third. The relatively high fiscal stimulus of the Sudan takes into account the significant hike in salaries of public sector employees. Saudi Arabia ranks fourth although it announced the largest stimulus in the region in value (about \$49 billion). Sustaining such a high level of fiscal stimulus in the future would be a challenge if the COVID-19 pandemic is prolonged. The lack of adequate fiscal space is a major challenge to extending fiscal stimulus for the low- and middle-income countries of the region.

Nearly 11 per cent of the announced fiscal stimulus is targeted at people, through social protection and health related measures, and nearly 40 per cent are targeted at supporting small and medium enterprises (SMEs) and businesses in the Arab region.

The global average of the respective shares is slightly lower (figure 5). About half of the announced fiscal stimulus, globally as well as in the Arab region, does not have a clearly distinguishable target beneficiary. The incidence of beneficiaries will be clearer as the measures get implemented.

Cash transfers and income support measures top the list of common social protection policy measures announced in the Arab region and worldwide.

Other common measures between the world and the Arab region include in-kind transfers and food vouchers, the extension of paid leave or work from home, and support regarding the relaxation of labour regulations (figure 6). A significant difference between global and Arab region stimulus measures is unemployment benefits which are the second most planned measure globally, but not in the Arab region. Only few countries in the region have announced compensation to employees who have lost jobs for a limited period.

An overwhelming share of fiscal stimulus to SMEs and businesses is in the form of soft loans and credit support in the Arab region and worldwide.

In the region, 94 per cent of the stimulus announced to SMEs and businesses (\$11 billion) are in the form of soft loans. Loans and interest deferment, and cash-flow assistance to SMEs and businesses are the other important measures announced in the region. Globally, 84 per cent of the stimulus plans announced for SMEs and businesses (\$3.9 trillion) are in the form of soft loans. Tax exemptions or reductions and cash-flow assistance are two other important measures. Upon implementation of all measures, the total value of support measures to SMEs and businesses will be clearer.

Figure 4. Government fiscal stimulus (% GDP): top 10 countries in the Arab region

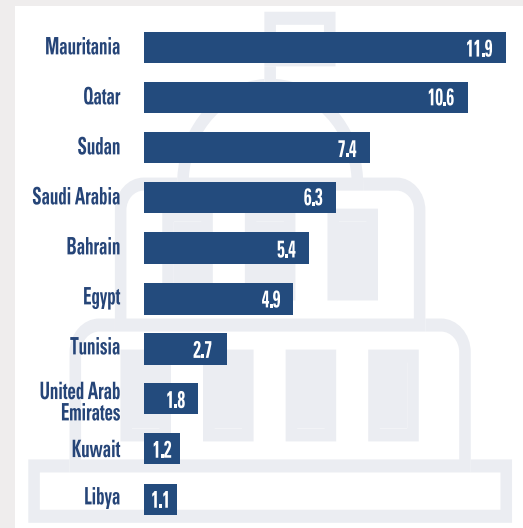


Figure 5. Who gets how much from the government stimulus?

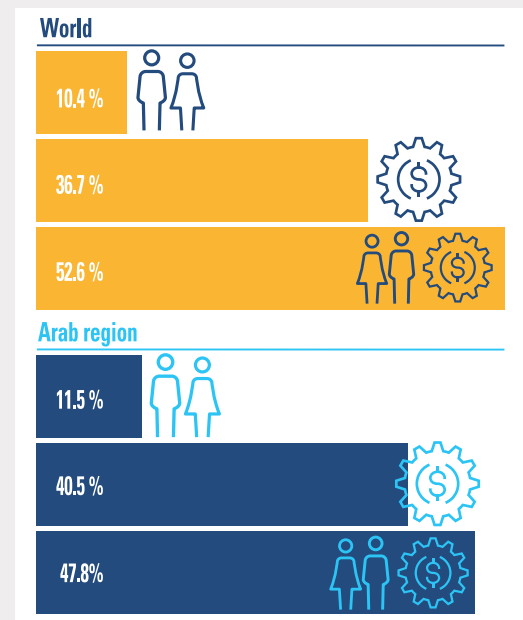


Figure 6. Top 5 policy measures of social protection

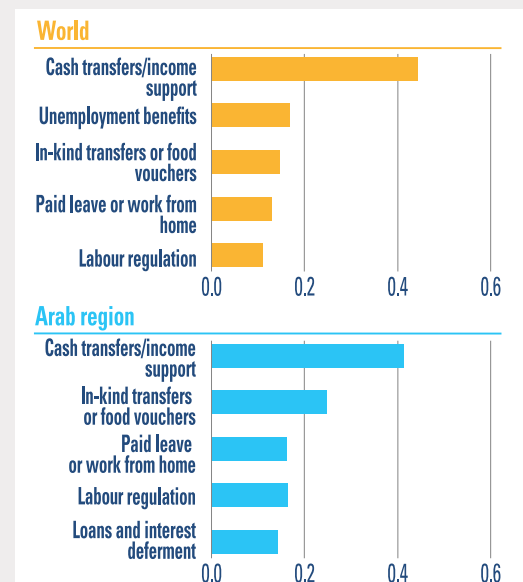
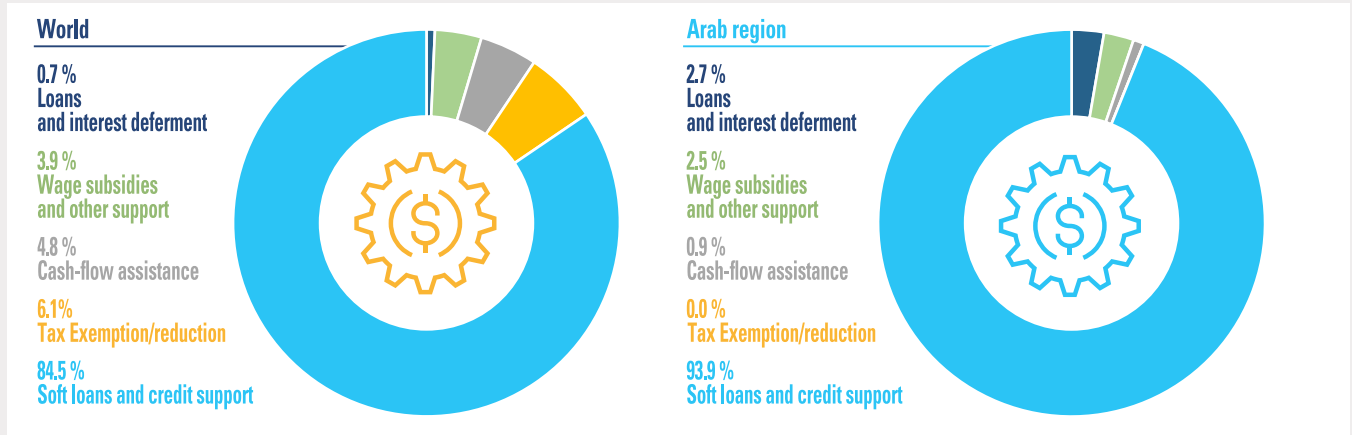


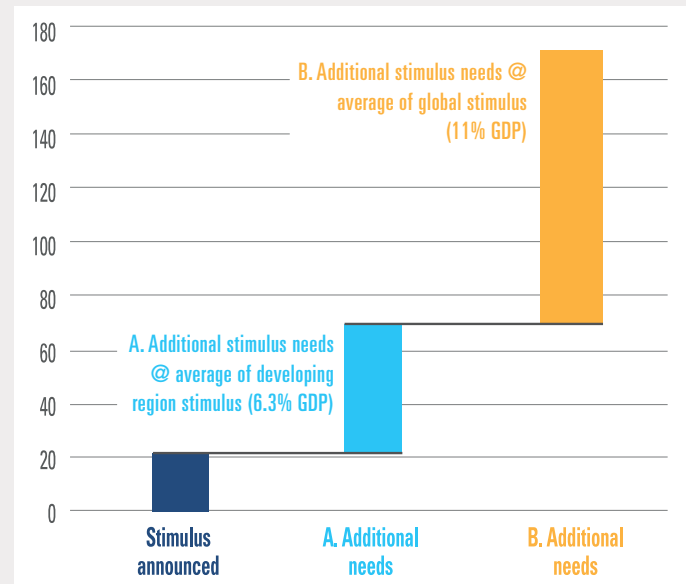
Figure 7. Distribution of stimulus across policy measures targeted at SMEs and businesses (%)



Fiscal stimulus needs of the region to better recover from the COVID-19 pandemic

Compared to developing regions' average stimulus as a share of GDP (6.3 per cent), the region's low- and middle-income countries need at least an additional \$50 billion to fight COVID-19. The needs could go up to \$100 billion to better recover if a global average of 11 per cent GDP is considered (figure 8). Given the limited fiscal space, low- and middle-income countries face greater risks in meeting expenditure needs as domestic revenues have plummeted due to lockdown measures and loss of economic activities.

Figure 8. Additional fiscal stimulus needs for the low- and middle-income countries of the Arab region (\$ billion)



Measures to bridge the fiscal needs to fight the adverse impact of COVID-19

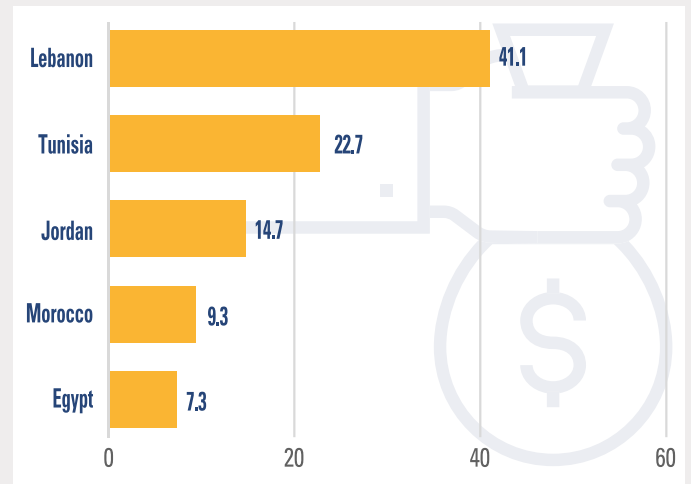
While there is a greater need for more fiscal stimulus, the effectiveness of the stimulus would require channeling investments into survival: **survival of people** and **survival of SMEs and businesses** in order to recover better. In this context, extending debt relief to all LDCs and highly indebted middle-income countries, providing concessional loans, fulfilling commitments to deliver aid, harnessing solidarity from the wealthy and private sector and "smart spending" are some of the key measures to bridge the fiscal needs to fight the adverse impact of COVID-19.

1. **Official creditors are called upon to extend debt service moratorium to highly indebted middle-income countries in the region, in addition to the LDCs, which can free up about \$15 billion in foreign currency.** In the region, three out of the six LDCs have obtained debt service relief that was extended by G20 since April 2020. There is a need to extend the debt service relief to all LDCs in the region and it is also imperative to do so it at least until 2021. In addition, the moratorium on external debt service payments should be extended

to highly indebted middle-income countries at least till the end of the year. This would free up significant foreign currency obligations to purchase essential imports since the external debt service accounts for a high share of revenues in several middle-income countries of the region (figure 9). Debt restructuring and debt swap are other important mechanisms to free up the fiscal space to mitigate the impact of COVID-19.

2. **Increase access to concessional loans for the middle-income and vulnerable countries with the aim to improve financing for the Sustainable Development Goals (SDGs):** Given the adverse impact of COVID-19, multilateral and bilateral creditors should consider concessional terms for any augmentation of existing lending programmes or new financing arrangements to vulnerable and middle-income countries. It is also imperative to review and redesign international debt sustainability frameworks toward supporting SDG financing and recovering better from COVID-19 without adding significant fiscal stress on countries.
3. **Global commitment to deliver official development assistance (ODA), at least by maintaining current levels, is important to avert possible shortfalls in health spending in the Arab region.** Multilateral organizations and international financial institutions need to consider increasing grants and technical support to vulnerable countries as committed under the Addis Ababa Action Agenda.
4. **Solidarity from the wealthiest countries can contribute to creating a strong “regional social solidarity fund”** to support the vulnerable countries, including the LDCs, as proposed by ESCWA’s Regional Emergency Response to mitigate the impact of COVID-19. The fund should target the poor and vulnerable, ensure a rapid response, and provide relief during food shortages or health emergencies.
5. **A solidarity fund, outside public budget and managed by the wealthiest, can contribute to uplift and create opportunities for the poor.** The region is highly unequal, with a high concentration of wealth at few hands. A 2 per cent solidarity contribution to the fund from the top 10 percentile of the wealthiest in the region can bridge the need gap to meet poverty impact of the COVID-19 in low- and middle-income countries.

Figure 9. External public debt service (% of revenues)



6. “Smart spending” to improve the fiscal space.

The choice of expenditure and targeting mechanisms can play a role in driving growth, addressing poverty and distributional consequences, and harnessing SDG linkages. Establishing a

“Social Expenditure Monitor” to inform decisions to rebalance the priorities in spending, improving transparency and minimizing leakages in overall public finance management are key enablers for “smart spending” to improve fiscal space.

7. **The private sector needs to strengthen solidarity to address the negative impacts of COVID-19.** Limiting job lay-offs and helping the survival of SMEs that are most vulnerable require strong solidarity from large businesses and corporations. Rental relief and suspensions, favouring SMEs in procurement and subcontracting and integrating them in supply chains are some of the critical measures to support SMEs. Private banks should consider the temporary suspension of interest and principal from SMEs and the self-employed during the COVID-19 crisis.

