Social Spending Monitor

Debt distress in MENA and its implications for social spending on children

Summary

Despite a better economic forecast for 2021–2022, the United Nations warns that COVID-19 could drive an additional 8.3 million people into poverty in the Middle East and North Africa (MENA), with increasing inequality adversely affecting vulnerable groups. As one of the most highly indebted regions in the world, MENA has limited fiscal space to finance the additional spending needed to counteract the socio-economic effects of the pandemic.

The diverse countries of the region face different economic challenges, with some harder hit than others by the pandemic. This brief analyses how debt might impact on social spending in seven countries: Djibouti, Egypt, Lebanon, Morocco, Tunisia, Sudan and Yemen. Despite the increasing debt burden these countries face, only two – Djibouti and Yemen – are currently receiving debt relief under the G20 Debt Standstill (although Sudan has recently qualified for debt relief under Highly Indebted Poor Countries). Extending the G20 Debt Standstill and introducing alternative options for middle income countries to reschedule their debt payments without negatively affecting their credit ratings could provide a valuable opportunity for governments to invest in better education, health and social protection services in the wake of the pandemic.

MENA countries face a combination of declining government revenue and additional spending needs triggered by COVID-19. In the short term, most have initiated additional social spending in response to the pandemic. However, they have also increased borrowing during this period, with three countries – Bahrain, Lebanon and Sudan – having debt-to-GDP ratios of over 100 per cent. While for some countries borrowing may be a strategic option to improve social and economic spending during the crisis, it is crucial that governments adopt sustainable debt financing strategies so that future generations are not negatively impacted by growing levels of debt.

for every child, answers

In the face of increasing debt repayments, it is important that fiscal austerity does not threaten future public investment in social services. Already, social expenditure risks being crowded out by debt service repayments. Average social expenditure in this group of countries remains well below global benchmarks. All except Sudan spend more on debt service than on health expenditure: Yemen, Lebanon and Djibouti currently spend over 5 times as much. Future social spending, with a focus on equity and efficiency, must be maintained in order to progressively realize the rights of all children.

As they come out of the pandemic, MENA countries require greater access to debt relief (including debt restructuring options) and concessional financing to open up fiscal space for protecting and improving social sector spending. In addition, increased budget transparency is required to monitor the effects of debt distress on the fiscal space for social spending. Debt management also needs to be transparent, with investment to enhance debt data reporting and quality, information disclosure and public engagement.

Governments should employ robust models to obtain foresight on the impact of high debt repayments on government social sector budgets. Increased government borrowing can be a beneficial response to an economic downturn if borrowing is used to finance public investment and stimulate future economic growth. Such models should monitor the key indicators of the channels of transmission (actual and potential): from economic shocks, government revenue pressures, higher deficit financing, higher debt burden to impact on government social sector budgets.

Overview

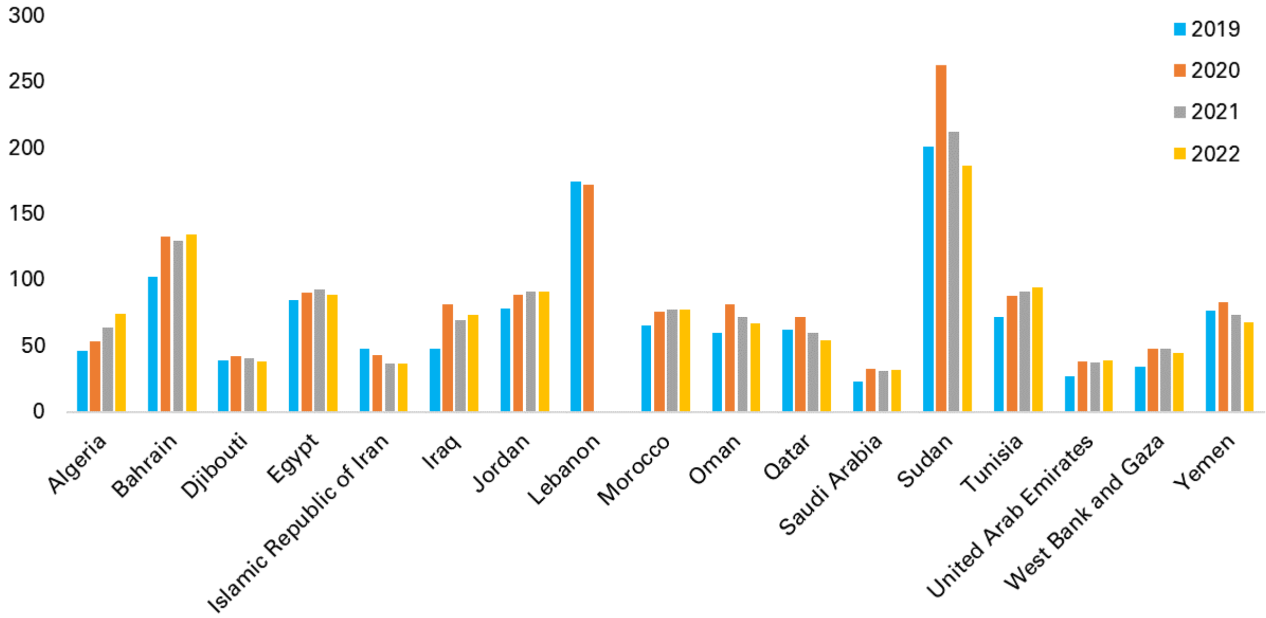
The MENA region is one of the most highly indebted regions in the world. COVID-19 has hit the region's economy hard, with economic output expected to contract by, on average, 3.6 per cent and 3.8 per cent[1] between 2019 and 2021 (IMF, WEO, WB 2021). The prospects for economic recovery are threatened by inflation, rising interest rates and the domestic and geopolitical instability facing the region. Although most countries in MENA have increased spending on social safety nets as a short-term response to COVID-19,[2] the UN warns that the pandemic could drive an additional 8.3 million people into poverty in the region, and further affect political instability in the region.[3]

The space for additional social spending to alleviate the socio-economic impact of the pandemic is in particular limited in many countries by the high government debt levels. General government gross debt-to-GDP ratios stood at an average of 87.2 per cent across MENA in 2020, with debt in three countries – Bahrain, Lebanon and Sudan – comprising over 100 per cent of GDP (*see Figure 1*). While Lebanon, unable to meet its interest payments on a 1.2bn Eurobond, defaulted on its public debt in March 2020, its debt levels of almost 175 per cent of GDP were until recently dwarfed by those of Sudan. Sudan's sovereign debt amounted to 259 per cent of GDP in 2020, the fastest growing debt in the region, rising almost 50 percentage points

[1] World Bank, 2021, Living with Debt: How Institutions Can Chart a Path to Recovery in the Middle East and North Africa
[2] IMF Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic
[3] https://www.unicef.org/social-policy/child-poverty/covid-19-socioeconomic-impacts

between 2019 and 2021 (an increase of 25 per cent). However, in June 2021, Sudan qualified for debt relief under the Highly Indebted Poor Countries (HIPC) initiative, which has the potential to reduce over 90 per cent of Sudan's external debt in three years, depending on the continuance of economic and policy reforms.[4] Most other countries in the region have also increased borrowing since the beginning of the pandemic, the only exception being Iran, where government debt fell by 5 percentage points during this period (*see Figure 2*).

Figure 1. Government debt-to-GDP ratio by country, 2019–2022

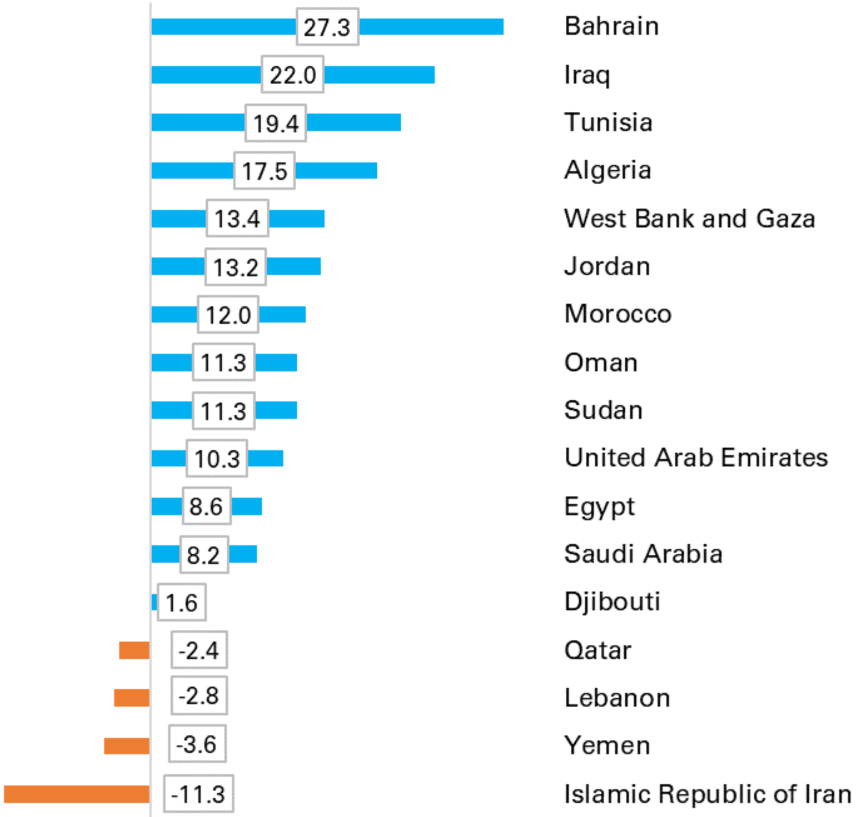


Source: IMF, World Economic Outlook Database, April 2021. Based on general government gross debt, estimates start after 2019.

Sovereign debt makes up over two thirds (69 per cent) of total external debt in low- and middle-income countries in MENA (see Figure 3). Historically MENA countries have had limited access to international financial markets, which some argue has been pivotal in avoiding severe debt crises in the past (Economic Research Forum). Increased public spending in Gulf Cooperation Countries (GCC) may have also meant the impact of the COVID-19 pandemic on public debt and exchange rates has only been moderately felt in GCC countries so far (ibid). However, limited access to external financing means that governments have had to turn to domestic banks, with banks' exposure to the public sector above 45 per cent in Algeria and Egypt and over 60 per cent in Lebanon (IMF, 2021).

[4] https://www.worldbank.org/en/news/press-release/2021/06/29/sudan-to-receive-debt-relief-under-the-hipc-initiative

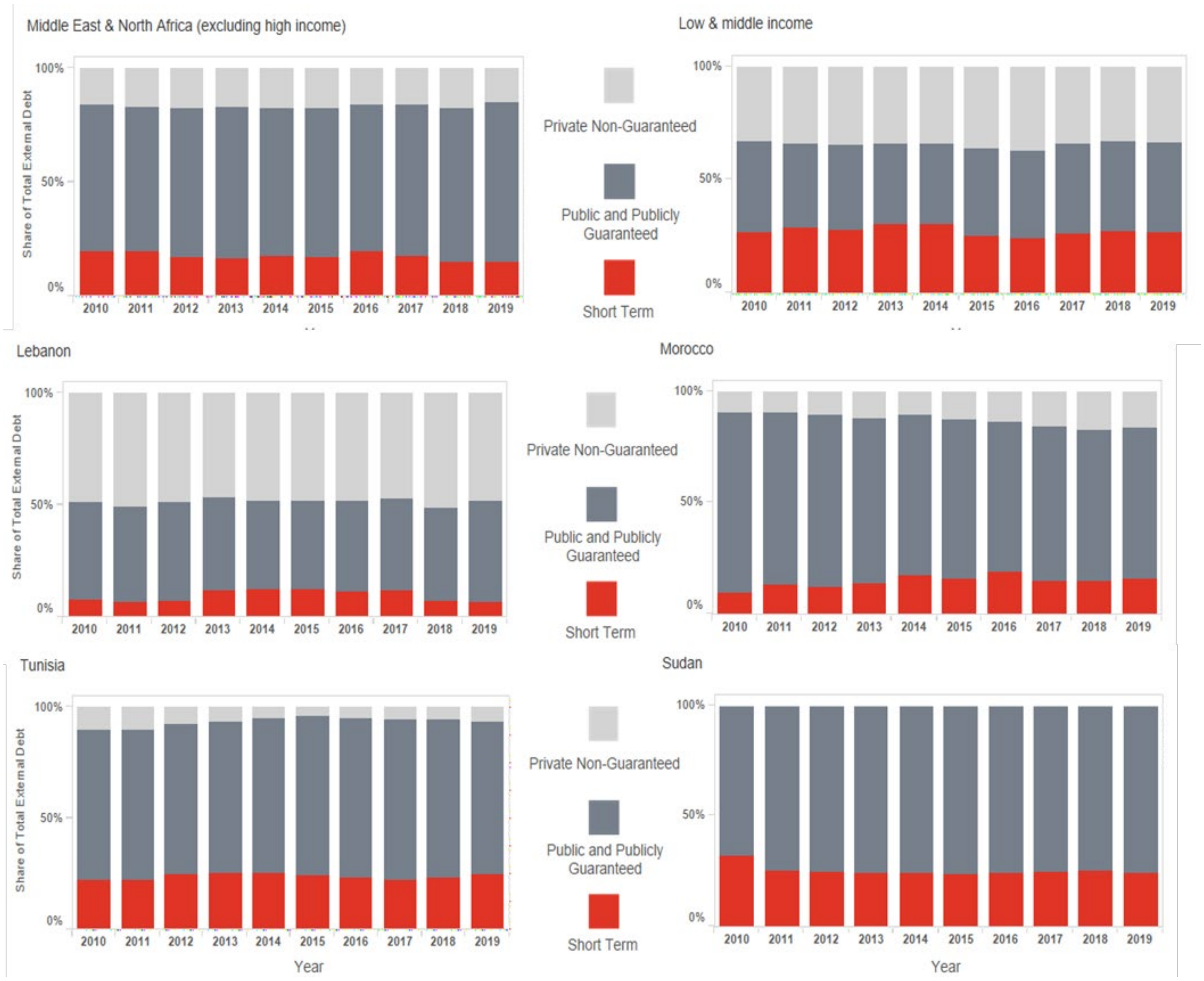
Figure 2. Percentage point rise in government debt between 2019 and 2021



Source: IMF, World Economic Outlook Database, April 2021. Based on general government gross debt. Data for Lebanon based on 2019–2020. Estimates start after 2019.

Although the level of private debt in the MENA region is comparatively low in relation to average levels in low- and middle-income countries, several MENA countries are seeing increasing levels of private, non-guaranteed debt (see Figure 3). Private debt comprises on average 15 per cent of total external debt in MENA countries (excluding high income), compared with an average of 33 per cent across low- and middle-income countries. However, private debt levels are increasing in several MENA countries: in Morocco, private debt has grown from 9 to 16 per cent of total external debt over the past 10 years; in Lebanon private debt now stands at almost half (48 per cent) of total external debt (see Figure 3). While the burden on public and publicly guaranteed debt impacts most directly on government spending capacity, private debt levels may also impact on the overall stability of the economy, especially in times of crisis. Similarly, while short-term debt remains relatively low in the region, Tunisia and Sudan both have above average short-term debt comprising almost a quarter (24 per cent) of total external debt in 2019 (*see Figure 3*). Short-term debt also comes with high associated costs and a shorter repayment schedule, which may put pressure on governments as they deal with the economic impact of the pandemic.

Figure 3. External debt composition in selected countries, 2010–2019



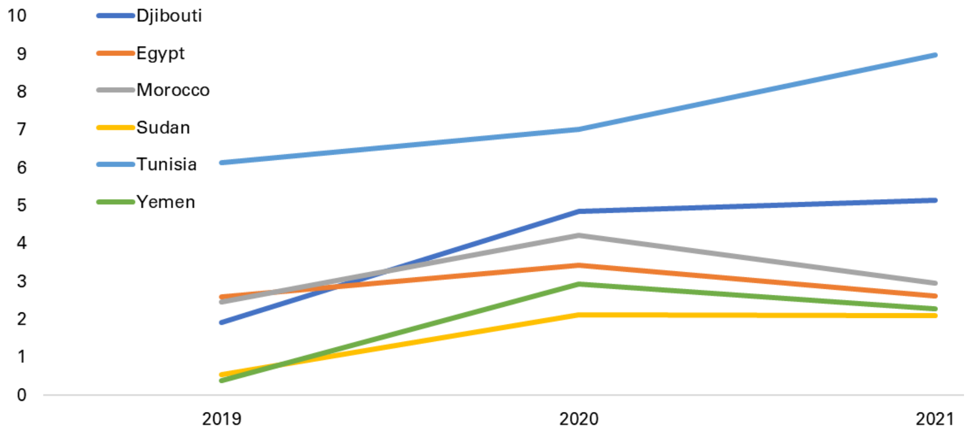
Source: [World Bank International Debt Statistics, 2021](). Note aggregate data for 'Middle East and North Africa (excluding high income)' does not include data for Sudan.

Countries at risk

IMF categorises three countries in the region as at risk of debt distress: Sudan (in distress), Djibouti (at high risk), and Yemen (at moderate risk). IMF risk assessments focus on macroeconomic indicators to assess a country's vulnerability to economic and policy shocks, with published assessments focusing mainly on low income countries. Consequently, not all MENA countries are included in the IMF's published risk assessment, which focuses on low income economies. Alternative measures of risk, such as those used by the Jubilee Debt Campaign, assess the extent to which debt payments are undermining a government's ability to protect the economic and social rights of its citizens. Using this measure, another 4 countries are added to this list: Egypt, Lebanon, Morocco, Tunisia.[5] As the analysis below reveals, debt service in these seven countries is taking up an increasingly large proportion of government expenditure in the context of declining revenues in the wake of COVID-19.

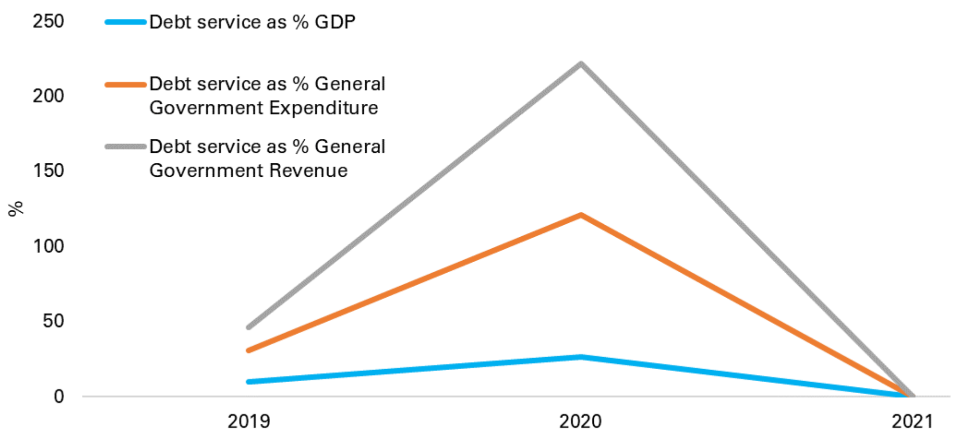
Since 2019, debt payments as a percentage of GDP have risen sharply in all seven countries (*see Figures 4.1 and 4.2*). Debt interest will reach 9.0 per cent of GDP in Tunisia in 2021; 5.1 per cent of GDP in Djibouti; and between 2 and 3 per cent of GDP in Yemen, Morocco, Egypt and Sudan. Although the burden of debt interest has not reached the level of Lebanon when it defaulted in 2020, of 26.9 per cent of GDP (*see Figure 4.2*), these countries face debt repayments much higher than the regional average of 1.6 per cent of GDP. Debt repayments in Tunisia are particularly high.

Figure 4.1. Debt service on external debt as a proportion of GDP



Source: World Bank, International Debt Statistics, last updated 09/03/2021; IMF, World Economic Outlook Database, April 2021

Figure 4.2. Lebanon: debt service as a proportion of GDP, revenue and expenditure



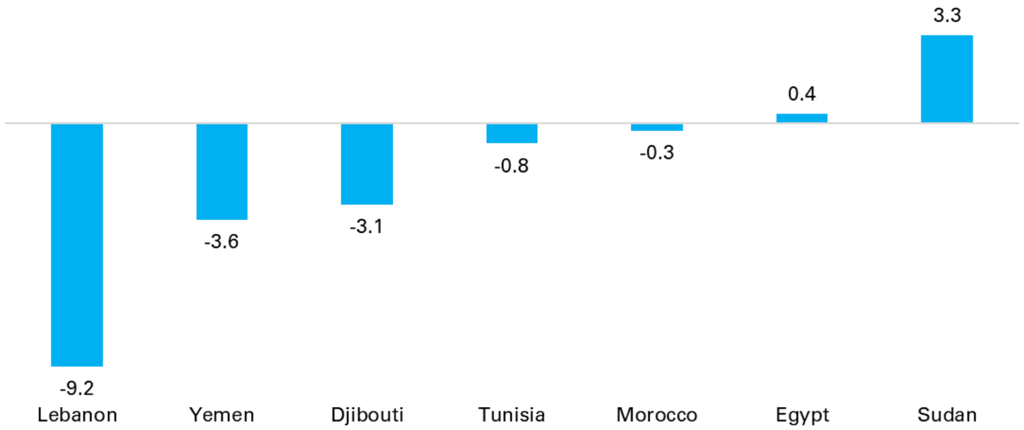
Sources: World Bank, International Debt Statistics, last updated 01/21/2021; IMF, World Economic Outlook Database, October 2020. Based on public and publicly guaranteed external debt.

[5] https://data.jubileedebt.org.uk/. Note. Although Lebanon is now in default, it is still seeking to negotiate its sovereign debt.

Impact of debt on public spending

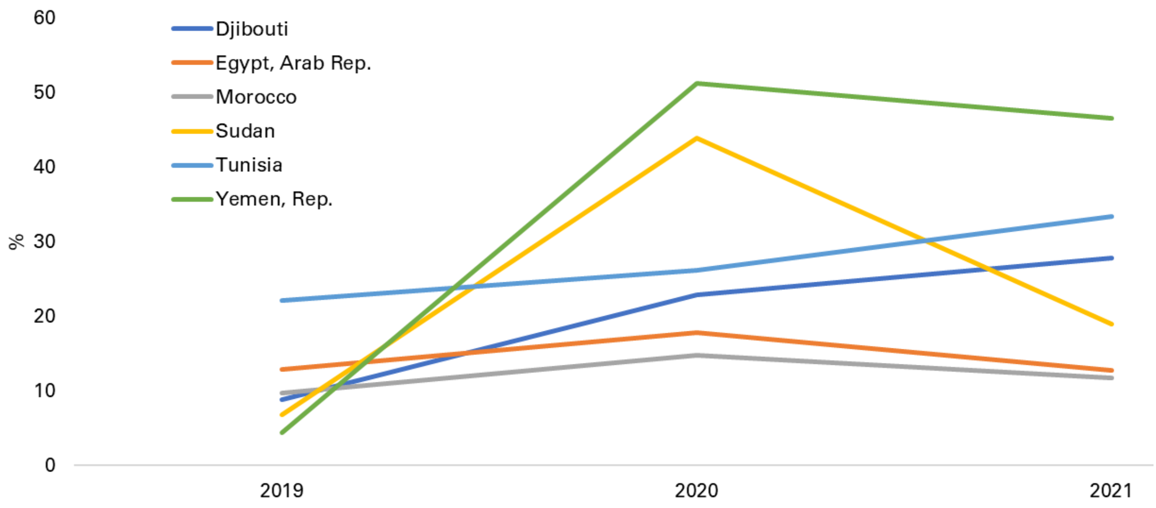
Given revenue constraints, this level of debt represents a real risk of debt payments crowding out social expenditure. Five of these seven countries experienced a decline in government revenue between 2019 and 2021, with Lebanon's overall revenue dropping 9.2 percentage points between 2019 and 2020 (data for Lebanon is missing for 2021). Sudan on the other hand saw an increase in government coffers of 3.3 percentage points. In tandem, with the exception of Sudan, debt service continued to increase as a proportion of government revenue across this group of countries. Lebanon's debt service reached 221.8 per cent of total revenue in 2020. The trajectory in Yemen appears equally serious, with debt service now comprising well over half of total government revenue, rising from 4.4 to 57.8 per cent in the last three years (*see Figure 5*). Tunisia and Djibouti also saw debt service rise to a significant proportion of government revenue during this period. In Tunisia, debt service is now over a third of government revenue; in Djibouti, over a quarter, up from 8.8 per cent in 2019 (*see Figure 6*).

Figure 5. Percentage point growth in government revenue, 2019–2021



Sources: World Bank, International Debt Statistics, last updated 01/21/2021; International Monetary Fund, World Economic Outlook Database, April 2021.

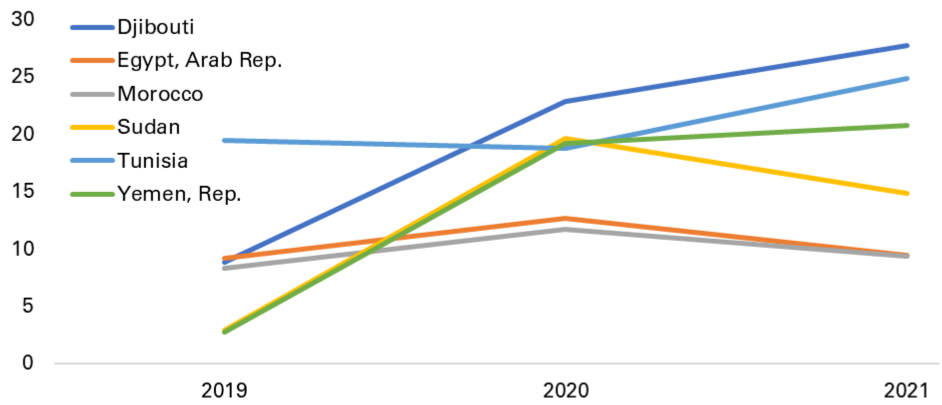
Figure 6. Debt interest payments as a proportion of government revenue



Sources: World Bank, International Debt Statistics, last updated 01/21/2021; International Monetary Fund, World Economic Outlook Database, April 2021. Estimates start after 2019. Based on debt service on public and publicly guaranteed debt.

Consequently, debt payments owed represent a significant proportion of government expenditure in the countries affected. Debt service equates to around a quarter of total government expenditure in Djibouti and Tunisia in 2021, and a fifth of total expenditure in Yemen.[6] In all three countries this represents a rise on 2020 levels. Debt interest in Sudan, Egypt and Morocco should flatten off this year, after a high of 16.3 per cent of government expenditure in 2020 (*see Figure 7*). In comparison, average health expenditure between 2010 and 2018 was 9.3 per cent of GDP across this group of countries, far below the global benchmark of 15 per cent (Abuja Commitment of 2011). With the exception of Sudan, all seven countries spend more on debt service than on health expenditure, and (for those countries where data is available) more on debt service than on education. Yemen, Lebanon and Djibouti spend over 5 times as much on debt service than on health expenditure (*see Table 1*).

Figure 7. Debt service as percentage of government expenditure



Sources: World Bank, International Debt Statistics, last updated 01/21/2021; International Monetary Fund, World Economic Outlook Database, April 2021. Estimates start after 2019. Based on debt service on public and publicly guaranteed debt.

Table 1. Education and health spending as a proportion (per cent) of total government expenditure, 2020

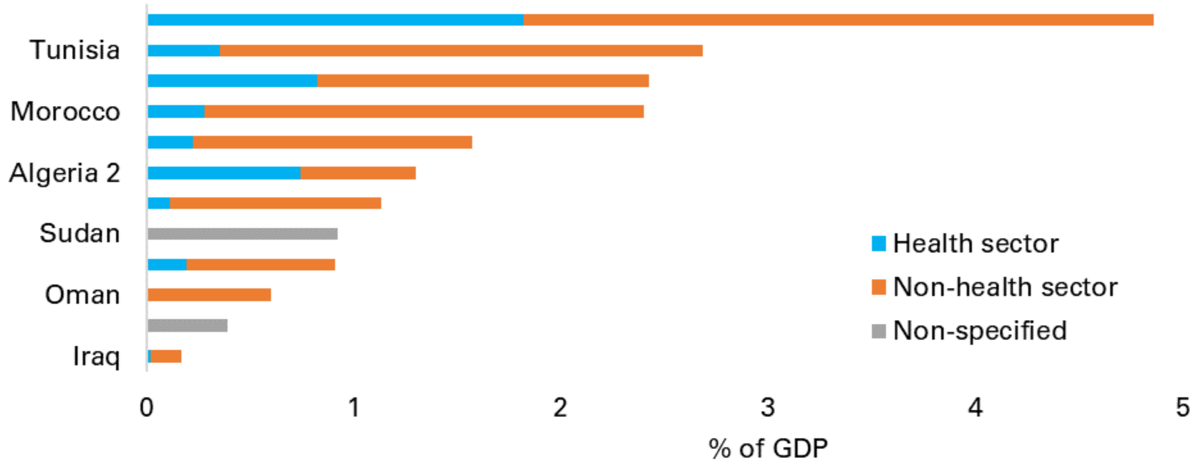
Country	Debt	Health	Education
Djibouti	27.7	4.1	12.3
Egypt	9.4	5	–
Lebanon	120.9	14.3	8.6
Morocco	9.3	7.7	–
Sudan[7]	14.8	18.1	–
Tunisia	24.8	13.9	24.8
Yemen	20.1	2.2	–

Sources: SOWC (2010–2018), WEO (2021). Based on latest available data.

[6] Yemen and Djibouti are both eligible for the G20 debt service standstill, which has stalled payments on official bilateral debt since May 2020. However, debt payments are currently due to resume in June 2021.
[7] Important to note that given the ongoing situation in Sudan, these figures might have changed

In the short term, MENA countries across the region have responded to the COVID-19 pandemic with additional financing. According to the IMF, MENA countries spent an average of 1.6 per cent of GDP on additional spending and foregone revenues, and a further 2.3 per cent of GDP on liquidity support in COVID-19 response since January 2020.[8] Support for the health sector sees, on average, an additional 0.5 per cent of GDP going to additional health spending across the region, with other sectors such as social protection also receiving additional funding.[9] (*See Figure 8*).

Figure 8. Additional spending, as a proportion of GDP, in response to COVID-19



Source: IMF Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 pandemic. Note: includes accelerated spending and deferred revenue

Access to external financing

For some countries, additional financing in response to the pandemic is facilitated by COVID-19-related emergency financing from the IMF. Table 2 shows the countries accessing these packages to date. Egypt, Jordan and Tunisia have all substantially increased borrowing from the IMF, with Egypt receiving USD 7,992m, Jordan USD 1,696m and Tunisia USD 745m in emergency financing.

[8] IMF Summary of Country Fiscal Measures in Response to the COVID-19 Pandemic, Estimates as of end December 2020, author's calculations.

[9] IMF Summary of Country Fiscal Measures in Response to the COVID-19 Pandemic, Estimates as of end December 2020, author's calculations.

Table 2. MENA countries accessing COVID-19-related IMF emergency financing

Country	Type of Emergency Financing	Amount approved as of March 2021 (USD million)
Djibouti	Rapid Credit Facility (RCF)	43.4
	Catastrophe Containment and Relief Trust (CCRT) 1st Tranche	2.3
	Catastrophe Containment and Relief Trust (CCRT) 2nd Tranche	2.38
Egypt, Arab Republic of	Rapid Financing Instrument (RFI)	2,772
	Stand-By Arrangement (SBA)	5,200
Jordan	Rapid Financing Instrument (RFI)	396
	Extended Fund Facility (EFF)	1,300
Tunisia	Rapid Financing Instrument (RFI)	745
Yemen, Republic of	Catastrophe Containment and Relief Trust (CCRT) 1st Tranche	19.76
	Catastrophe Containment and Relief Trust (CCRT) 2nd Tranche	15.45

Source: https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker#AFR

As the only IDA countries in the region, Djibouti and Yemen are also eligible for the G20 Debt Service Suspension Initiative (DSSI). DSSI offers a temporary suspension of debt-service payments on official bilateral debt between May 2020 and December 2021. These countries are also eligible for IMF and World Bank concessional lending due to their relative poverty. Djibouti is currently benefitting from significant relative savings of USD 123.5m, or over 2 per cent of GDP, under the G20 DSSI.[10] In addition, it has received USD 48.1m in additional IMF COVID-19 lending through the Catastrophe Containment and Relief Trust and the Rapid Credit Facility. Yemen is saving the equivalent of 0.6 per cent of GDP (or USD 349.2m, between May 2020 and June 2021), and has received an additional USD 35.2m in COVID-19 lending. Separately, Sudan has recently qualified for

[10] https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative

debt relief under the HIPC initiative, allowing for savings of over USD 50bn in current terms if certain criteria are met for the next three years.[11] Despite this, the IMF projects that even if the expected debt relief is to follow from June, debt service payment will average close to USD 128 million annually during calendar years 2021 to 2024.[12] In addition, the rest of the region will need to continue to service their debt despite the economic downturn.

Conclusion

COVID-19 triggered an unprecedent global crisis that requires large investments to reactivate economic growth in many regions, including MENA. It also provides an opportunity to initiate or expand programmes that directly protect families from the social and economic impacts of the crisis, as countries begin to build back better.

In response to the economic downturn triggered by the COVID-19 pandemic, most governments in MENA have increased borrowing, adding to what is a significant debt burden across the region. While accessing new resources is key to mitigating the impact of the crisis, the diverse countries of the region face different challenges in ensuring sustainable borrowing. This brief has identified seven countries that may be most at risk of debt distress: Djibouti, Egypt, Lebanon, Morocco, Tunisia, Sudan and Yemen. In Lebanon and Sudan, debt-to-GDP ratios have already risen to unsustainable levels. Sudan's debt-to-GDP ratio reached higher levels than those which triggered Lebanon's default in March 2020 before qualifying for HIPC debt relief in June. While the other countries looked at here may have lower overall debt levels, they face the prospect of increasing debt payments in the context of declining revenue. Most affected are Yemen, Tunisia and Djibouti, where debt payments due in 2021 equate to one half, one third, and almost a quarter of total revenue respectively.

While most governments in MENA have increased spending as an immediate response to COVID-19, in the medium term the burden of debt interest threatens to crowd out social expenditure in affected countries. Only two countries in the region, Djibouti and Yemen, currently qualify for debt relief under the G20 debt suspension. While these countries, along with Egypt, Jordan and Tunisia, have been able to access IMF emergency financing in order to support additional spending, health and education expenditure remains well below global benchmarks. With the exception of Sudan, all seven countries spend more on debt service than on health, and all with the exception of Tunisia spend more on debt service than on education.

Increasing government borrowing can be a beneficial response to an economic downturn if borrowing is used to finance public investment and stimulate future economic growth. However, the benefits of public borrowing decrease once sovereign debt levels become unsustainable. This analysis has shown that debt repayments in some MENA countries leave little fiscal space for governments to finance the social expenditure that will be needed to 'build back better' in the wake of the COVID-19 pandemic. The current scenario therefore risks increasing inequality in highly indebted

[11] https://www.worldbank.org/en/country/sudan/overview#2

[12] International Monetary Fund (IMF). 2021. Jordan Country Report No. 21/11. IMF: Washington, D.C.

countries, with children amongst the vulnerable groups affected by continued low investment in social services. Countries in the region urgently require greater access to debt relief (including debt restructuring options) and concessional financing to protect and improve social sector spending as they come out of the pandemic.

Policy recommendations

COVID-19 triggered an unprecedent global crisis with the economic impact likely to impact on Government revenues in MENA in the years to come. Despite the current economic challenges, it is crucial that fiscal austerity is avoided. Future social spending, with a focus on equity and efficiency, must be maintained to progressively realize the rights of all children. The proposed extension of the G20 Debt Standstill until at least 2022 should require commitment on behalf of Governments to invest in better education, health and social protection services in the wake of COVID-19.

To support increased public investment in social sectors, governments should adopt macroeconomic policies to support poverty reduction and inclusive growth. This should include increasing fiscal space for social spending via domestic resources, through progressive taxation. Also, it will require implementation of optimum fiscal and monetary policies to manage the supply side of essential goods and services, including leveraging from the COVAX facility and accessing preferential procurement of immunization through UNICEF's supply division.

As countries recover from the economic effects of the pandemic, borrowing may be a strategic option to improve social and economic spending during the crisis, with sustainable public debt potentially an option for future social investment. This makes access to concessional lending crucial for all low- and middle-income countries. For countries with access to international markets, market-based financing alternatives such as government bonds may also be less expensive than conventional commercial bank loans. However, it is crucial that governments adopt sustainable and transparent debt-financing strategies and management practices that will allow the fiscal space to invest in quality and equitable social services urgently required.

Governments and development partners need to consider the inter-generational effects of current debt financing practices and debt relief measures. This will also require diversifying funding strategies and embedding sustainability components in their medium-term debt strategies. Future generations of children need not bear the consequences of imprudent and unsustainable debt management practices of current generations.