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Rethinking fiscal policy to finance SDGs in South Asia

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POLICY BRIEF

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Introduction

The Global Financial Crisis (GFC) of 2007-2009 and COVID-19 of 2020-2021 brought about significant changes to the way the macroeconomic policy framework is conceptualised and practiced. Connecting macroeconomic policy to the global development agenda dominated by the SDGs and the Paris Agreement on climate action is now considered essential. This does not mean that traditional strictures on macroeconomic stability are no longer relevant. One cannot ignore the malevolent consequences of high inflation, imprudent monetary policy, unsustainable debts and deficits, and currency crises. The challenge is to maintain a stable macroeconomic climate while recognising that it is necessary, but not sufficient, to attain the SDGs. Much more can be done—and needs to be done - by finance ministries as one of the key arbiters of country-level macroeconomic policies to ensure that such policies are aligned with the SDGs

This brief offers an illustration of a plethora of regional context of South Asia with some country-level practices in which the macroeconomic policy framework can be tethered to the SDGs and the Paris Agreement. Within the broad rubric of the SDGs and Paris Agreement, the discussion will highlight the linkages between macroeconomic policy, decent jobs, social protection, and transition to a 'net zero' economy by 2050 in a just manner.

The role of Ministries of Finance in supporting decent jobs, social protection and just transition: County level perspectives from South Asia

The discussion highlights the fiscal strategies that can be—and have been—utilised by Ministries of Finance at the country level to respond to a fundamental challenge: responding to the financing gaps in meeting the SDGs. This requires the enactment and implementation of SDG budgeting which ought to become a core part of strategic budgeting initiatives.

The key challenge: Financing gaps in meeting the SDGs

As the 2024 Financing SDGs for Report (henceforth FSDGR)[1] observes:

'The world is facing a sustainable development crisis. The 2024 *Financing for Sustainable Development Report: Financing for Development at a Crossroads* finds that financing challenges are at the heart of the crisis.

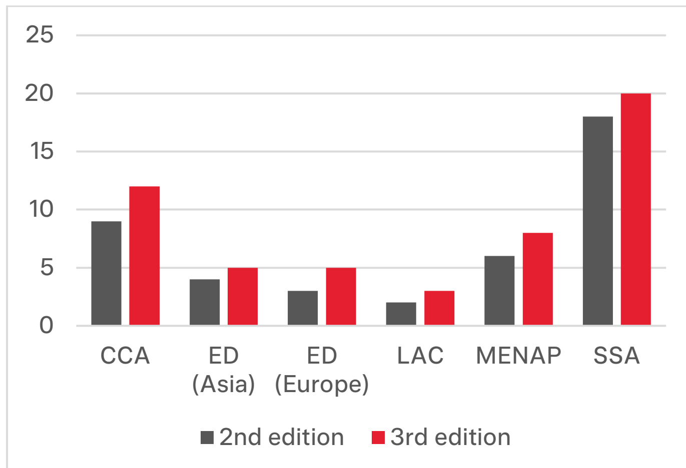
It is widely accepted that the financing gap in meeting the SDGs runs into trillions of dollars between 3 and 4.2 trillion dollars per annum at current prices according to the FSDGR, while meeting the objectives of just transition to a net zero economy by 2050 runs

into an additional USD 4 trillion per annum investment in clean energy technology.[2] This is the key hurdle that constrains the capacity of a vast number of countries to attain the SDGs. Furthermore, the current and projected macroeconomic climate and rising geopolitical tensions are not conducive to country-level efforts to meet the SDGs.

The IMF SDG costing tool[3] covers 173 countries and focuses on additional spending needs per annum in health (SDG 3), education (SDG 4), water and sanitation (SDG 6), electricity (SDG 7), and road infrastructure (SDG 9). It leaves out social protection and labour market programs that can support SDG 8 (pertaining to decent jobs) and climate action (SDG 13) and the goals of the Paris Agreement where this paper sheds some insights.

Figure 1 shows regional aggregates of annual spending needs to meet specific SDGs by 2030 as estimated by the IMF. It shows changes between 2019 (labelled as 'second edition' in blue) and 2022 (labelled as 'third edition' in red). As expected, at 19.4 per cent of GDP, SSA (Sub-Saharan Africa) represents the region with the highest financing gap followed by CCA (Caucasus and Central Asia: around 12 per cent of GDP) while LAC (Latin America and Caribbean) has the lowest financing gap (2.5 per cent of GDP). Emerging economies in Asia and Europe occupy a middling position (under 6 per cent of GDP). In all regions, spending needs have gone up between 2019 and 2022 reflecting the impact of the global pandemic.

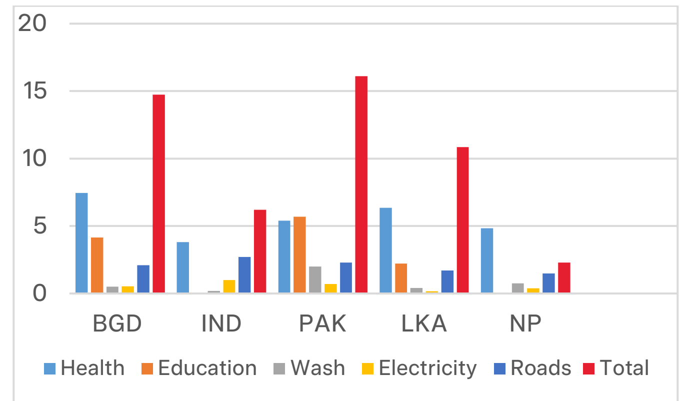
Figure 1: Additional annual spending needs to meet specific SDGs by 2030, by region, 2019 vs 2020 (% of GDP)



Source: Staff calculations, based on IMF SDG Costing Tool, second and third editions.[4]

Figure 2 reflects the country-level estimates of additional spending needs until 2030 to achieve the SDGs for South Asian region as a percentage of GDP in 2030. Bangladesh and Pakistan need around 15 per cent of their GDP in 2030 in total to be spent as additional spending disaggregated in five major areas health, education, wash, electricity and roads. These two countries need more fiscal space to finance their SDG targets linked with health and education more than the other areas. Sri Lanka requires about 11 per cent of its GDP for additional spending, with health being the most critical area. India and Nepal are better positioned in the region regarding the need for extra expenditure to achieve SDGs.

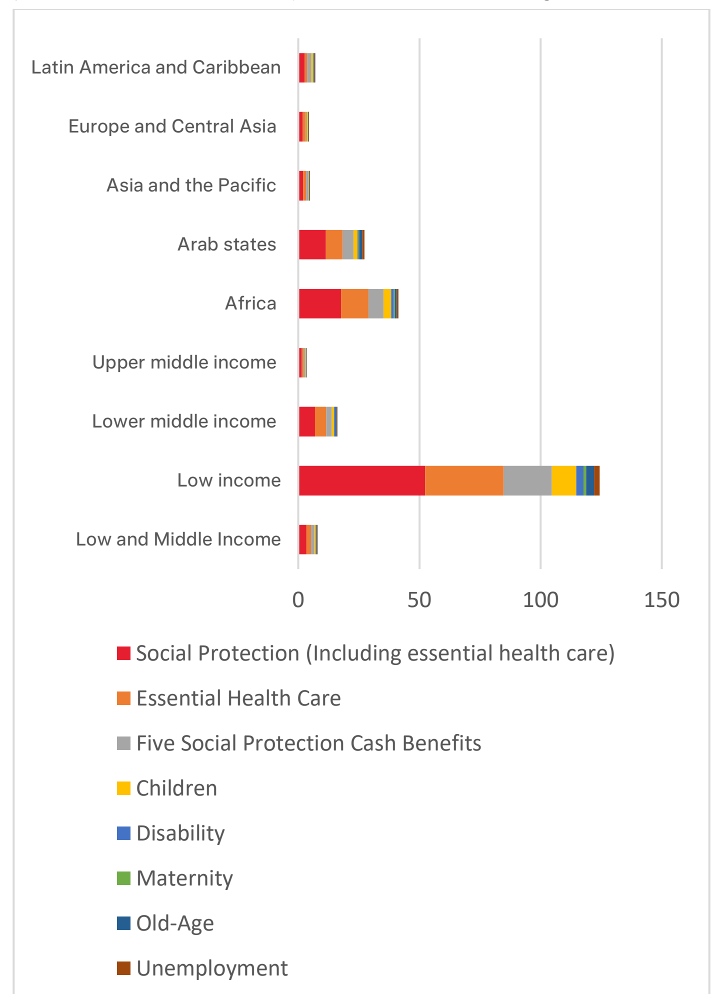
Figure 2: Estimates of additional SDG Spending Needs in 2030 (for each country expressed in per cent of 2030 GDP)



Source: IMF 2023, BGD = Bangladesh; IND= India; NPL= Nepal; LKA= Sri Lanka

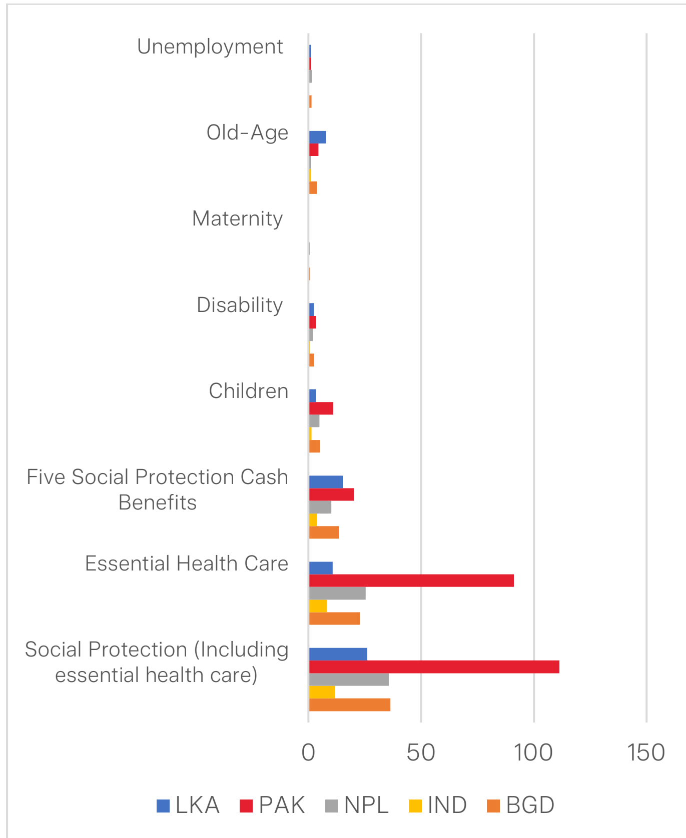
As noted, the IMF estimates leave out various elements of social protection. ILO has led the analytical and empirical work on estimating spending needs pertaining to universal social protection. The scope of social protection is defined to include mandated benefits in five categories: children, mothers, pensioners, disabled and the unemployed plus essential health care. The latest estimates are shown in Figure 3.

Figure 3: Financing gaps in attaining universal social protection (% of GDP), by income levels and regions



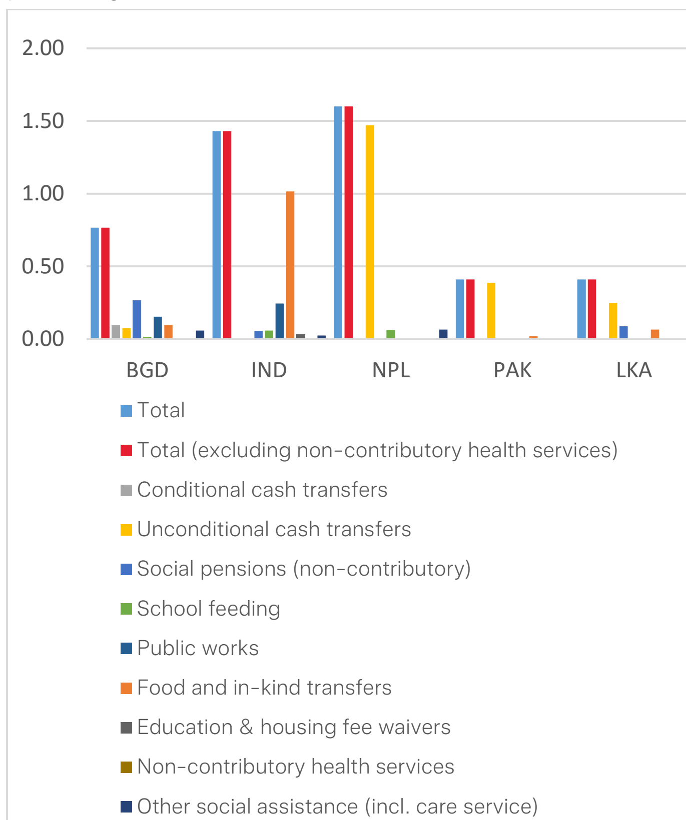
Source: ILO (2024)

Figure 4: Financing gap for social protection (as a % of Government Expenditure)



Source: Derived from ILO (2024). BGD = Bangladesh; IND= India; NPL= Nepal; LKA= Sri Lanka[5]

Figure 5: Annual social assistance spending as a percentage of GDP (2015-2021)



Source: World Bank 2023.[6] *BGD = Bangladesh; IND= India; NPL= Nepal; LKA= Sri Lanka*

It is clear from Figure 3 that the goal of universal social protection is simply unattainable for low-income countries even if they have the best policies in place and can make Herculean efforts to raise domestic revenue. There is no option other than significant development assistance for this cohort of countries to complement national efforts.

From a regional perspective, the lowest financing needs are in Europe and Central Asia, followed by Asia Pacific and Latin America and the Caribbean. As expected, the highest financing gap to meet the goal of universal social protection is in the African region.

Figure 4 exhibits that the financing gap in Pakistan is significantly larger than any other country in South Asia. Followed by Pakistan, data reveals that Bangladesh has a big financing gap in social protection as a share of government expenditure. India's financing gap for social protection is also reasonably high compared to the size of its government expenditure and economy relative to other South Asian countries. Figure 5 reflects that Bangladesh, India, Nepal, Pakistan and Sri Lanka are spending less than 2 per cent of their GDP in social in Annual Social Assistance with Nepal and India spending more than the others.

Figures 2 to 5 demonstrate that South Asian countries allocate comparatively lower levels of public expenditure towards health, education, water and sanitation, electricity, roads, and social protection assistance, which ultimately leads to a scarcity of decent employment opportunities within the labour market.

The role of VNRs in highlighting country-level approaches to SDG budgeting

One way in which one can seek to establish the extent to which countries align their fiscal framework to the SDGs is to consider the large and diversified sample of 'Voluntary National Reviews' or VNRs that member states submit to the UN's High-level Political Forum (HLPF) every year ever since this practice was initiated in 2016.

A 2022 UNU assessment[7] focuses on SDG budgeting by drawing on the 2021 VNRs. It found that there are multiple ways in which SDGs can be embedded in national budgets. These are: (1) SDG budget tagging, that is tracking national budgetary expenditures according to the SDGs; (2) developing an SDG-aligned budget performance report; (3) calculating SDG financing gaps; (4) integrating SDGs into local budgets.

Empowering UN member states to support SDG budgeting: the role of the Integrated National Financing Framework (INFF)

INFF is a framework first introduced in 2015 as a joint flagship initiative of the UNDP, DESA, UNICEF, the OECD, the EU and the governments of Italy, Spain and Sweden. A preliminary impact assessment of 17 INFF countries finds that approximately USD 16 billion of new sources of finance for SDGs have been generated, while USD 32 billion worth of SDG-aligned expenditure has been identified. In South Asia, Bangladesh, Nepal, and Bhutan implemented Integrated

National Financing Frameworks (INFF) in the development of fiscal policies and tools to finance Sustainable Development Goals (SDGs). Below are highlights of these INFF initiatives and country-specific cases in South Asia:

BANGLADESH: INFF in Bangladesh was implemented by UNDP, ILO, UNCDF and UN Women aiming mobilising the required public and private financial resources for the SDG. Bangladesh INFF focused on SDG 6 (water and sanitation), SDG 7 (energy) and SDG 13 (climate action), sustainable development areas where decent work plays a crosscutting role. Despite not being a direct goal in the form of SDG 8, the ILO has played a critical role in promoting decent work in the INFF by engaging in SDG 8 cost estimates.[8]

Chittagong Hill Tracts Rural Development Project in Bangladesh (ADB)

BHUTAN: Building on the country's development finance assessment, the Government of Bhutan aims to strengthen public and private financing and develop financial governance systems to support the SDGs within the timeframe of Bhutan's 12th Five-Year Plan (2018-2023).

NEPAL: Nepal's INFF is focused on developing coordination mechanisms to facilitate institutional linkages and interactions across planning, budgeting and financing frameworks. It provides a forum to address policy issues as they emerge, engage more consistently with the private sector, align development partner support, and promote civil society engagement to strengthen the demand side of governance.

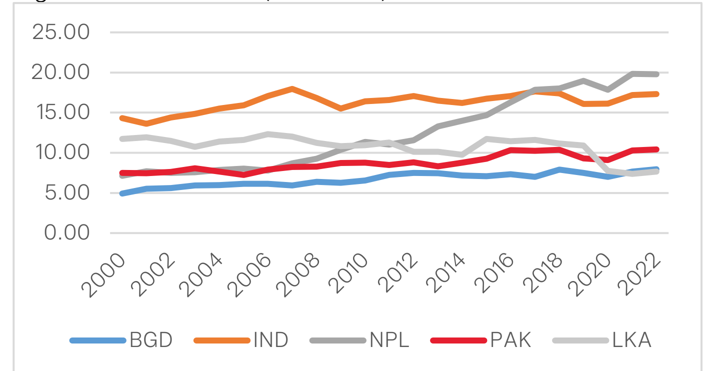
Fiscal strategies to support decent work, social protection, and just transition: the role of three key policy measures

Fiscal strategies cover multiple sources of financing channels that affect available resources for SDG spending: (1) domestic revenue mobilisation (DRM); (2) government debt and deficit; (3) spending and public procurement; (4) private financing. In South Asia, the combination of low domestic revenue generation, inadequate spending, and deterioration of economic conditions continues to lead to increasing fiscal deficits and weak macroeconomic buffers.

Raising tax revenue as a percentage of GDP

DRM consists of raising the tax-to-GDP ratio through appropriate reforms. This is a pivotal part of reducing the financing gap. Figure 7 shows that revenue-to-GDP ratios have not increased at desirable rates in recent years across all parts of the world and are likely to stagnate over the next five years.

Figure 6: Tax revenue (% of GDP) in South Asian countries



Source: IMF, 2024. BGD = Bangladesh; IND= India; NPL= Nepal; LKA= Sri Lanka

Overall, it seems that South Asian countries underexploit tax collection as a financing mechanism for social policies, which can be explained, to some extent, by structural factors such as low formal employment, widespread tax exemption and evasion, and weak tax administration. Figure 6 depicts India has been able to generate improvements in revenue collection through tax as its share of GDP. Nepal has been performing well since 2011. Bangladesh has been the poorest performer in the region to earn tax revenue as a share of its GDP.

According to an IMF assessment, low-income countries, including those in South Asia, have the potential to raise revenue by 6.7 percentage points and emerging economies by 2.3 percentage points.[9] Higher tax-to-GDP ratios in the developing world will yield substantial resources to support the financing of programs and policies pertaining to decent work, social protection and just transition.

Comprehensive reform is essential cutting across core domestic taxes—personal income tax (PIT), corporate income tax (CIT) and value-added tax. Such a reform agenda would encompass setting appropriate tax rates and strengthening the tax administration in South Asian countries.

As part of the agenda of DRM, one can highlight the initiative to raise excise taxes and extend their coverage on unhealthy products (alcohol, sugar-sweetened beverages, tobacco). These are also known as 'health taxes'. This could reduce the burden of non-communicable diseases (NCDs) while providing additional revenue targeted to support improvements in essential health care and other social protection and labour market programmes.

WHO notes that '(s)ince 2017, at least 133 countries have increased or introduced a new health tax'.[10] The results are encouraging and can be replicated in South Asian countries.

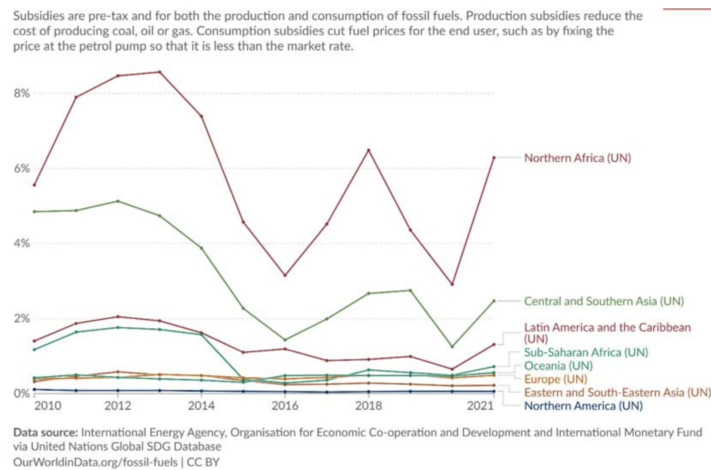
Fossil-fuel subsidy reform and carbon pricing

An important component of DRM that is aligned with climate action is the removal of fuel subsidies and introduction of carbon pricing. Fossil fuel subsidies can be a notable share of GDP in some regions of the world (as in Northern Africa)—see Figure 7. By sustaining fossil fuel-based industrialisation, fuel subsidies militate against the objective of just transition. In South Asia, Pakistan is set to introduce surcharges on fossil fuels as part of an aggressive revenue collection strategy outlined in the latest annual report by the Federal Board of Revenue (FBR).

The phasing out of explicit fossil fuel subsidies combined with carbon pricing can go a long way to respond to the need for climate action while creating additional fiscal resources for promoting policies and programs pertinent to decent jobs and social protection.

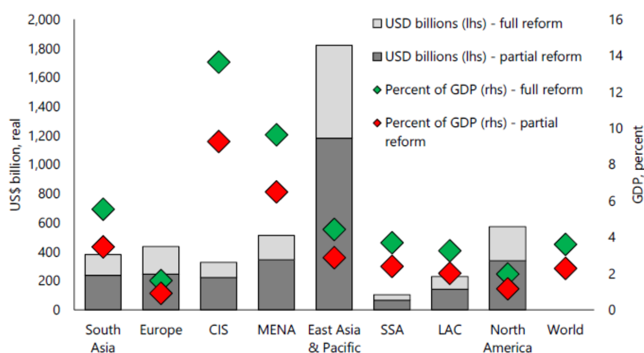
IMF estimated the fiscal and economic welfare impacts of the full reform of the fuel price with fossil fuel subsidies as a tool. Figure 8 depicts the revenue gain from a full price reform across the different regions and the global gain. South Asia as a whole stands to harness fiscal gains of USD 300 billion if policymakers in the region can engage in full fuel subsidy reform (Figure 9).

Figure 7: Fossil fuel subsidy as a share of GDP 2010-2021



Source : IEA, OECD, IMF and UN Global SDG

Figure 8: Revenue gain from full price reform, 2030



Source: IMF staff calculations. Note: revenue gain in $ terms for world is excluded for visualization purposes. Abbreviations are as follows: Commonwealth of Independent States (CIS), East Asia and Pacific (EAP), Latin America and the Caribbean (LAC), Middle East and North Africa (MENA), Sub-Saharan Africa (SSA) both figures in the panel.

Source: IMF Staff Calculation, 2023

Foundation wind energy I and II projects in Pakistan (ADB)

Issuing thematic sovereign bonds

Deficit financing to support SDGs is more problematic considering rising fiscal pressures in the post-COVID era. One can think in terms of a more targeted approach rather than a generalised increase in public debt. This pertains to the issuing of thematic sovereign bonds as a way of tapping into private capital markets. A UNDP assessment highlights three cases—Mexico (a pioneer in the field), Indonesia, Uzbekistan and Uruguay as examples of middle-income economies that have successfully issued thematic bonds.[11]

In South Asia, Bangladesh is poised to enter the thematic sovereign bond market. It has pledged to issue 'orange bonds' worth USD 1 billion geared towards the goal of gender equality and climate action within the SDGs.[12]

Thematic bonds from emerging economies are still a small fraction of the overall sovereign bond market (about 15 per cent).[13] Furthermore, low-income economies as well as South Asia will struggle to gain access to the thematic bond market given the fact that many such countries are at high risk of debt distress.

Sustainable public procurement

Public procurement pertains to the purchase of goods and services from the private sector by the government to support diverse public sector activities. Sustainable public procurement policies (SPP) can play an important role in supporting just transition and other development goals within an existing fiscal framework. The relative size of public procurement is 13 to 14 per cent of GDP across the world (as estimated in 2018).[14] Procurement activities account for 15 per cent of GHG emissions, while four industries (construction, defence, transport, and waste management) account for 53 per cent of such emissions in developing countries.[15] Hence, there is scope for SPP to contribute to the transition to net zero by 2050.

Unfortunately, none of the South Asian countries have significantly undertaken the practice of sustainable public procurement. Hence, there is scope for a new policy initiative that can support the SDGs.

RECOMMENDED ACTIONS:

In terms of policy recommendations, the following observations can be highlighted. They are meant to provide a basis for further discussions and deliberations within the South Asian community as it looks towards 2030 and beyond.

1. Strengthening macroeconomic institutions such as central banks, tax and customs bodies, commercial banks, and capital market regulatory bodies to undertake their due role to support strategic SDG budgeting.
2. Improving the overall investment climate of the South Asian countries to attract private investment and foreign direct investment.
3. Promoting impact investment, green financing, and crowdfunding.
4. Incentivising the business community for transforming into net zero carbon emission entities and adopting sustainable business strategies.
5. Adopting INFF for mapping the financing needs and gaps to achieve SDGs and mobilise domestic resources more effectively.
6. Using fuel subsidy reform, carbon pricing and health taxes to augment both domestic revenues and support specific SDGs.
7. Using the issuing of thematic bonds and sustainable public procurement as complementary fiscal strategies.

Conclusion

This paper used a plethora of country-specific examples from South Asia to show how fiscal policies can be used to support decent work, social protection, and just transition to a net zero economy. The large financing gap globally of around USD 4 trillion annually for the SDGs by 2030 and an additional USD 4 trillion for climate action is the key fiscal policy challenge. This is happening against a background of an insufficiently conducive global macroeconomic climate and rising geopolitical tensions. South Asian countries are especially vulnerable to such a fiscal policy challenge and would need substantial support from their development partners.

Enormous fiscal resources would need to be harnessed through strategic budgeting of which SDG budgeting is an underutilised approach. A key element of SDG budgeting is domestic revenue mobilisation by raising the tax-to-GDP ratio. The use of heath taxes, fossil-fuel subsidy reform and carbon pricing can both augment much-needed revenues while meeting fundamental socio-economic and environmental objectives. Complementary strategies include the issuance of thematic bonds and sustainable public procurement policies.

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