



# Debt and Fiscal Outlook Report for the Arab Region

Executive summary



Shared Prosperity **Dignified Life**





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Committed to the 2030 Agenda, ESCWA's passionate team produces innovative knowledge, fosters regional consensus and delivers transformational policy advice. Together, we work for a sustainable future for all.





## Executive summary

The Arab region faces significant stumbling blocks in realizing sustainable development and acting on climate change, complicated by a lack of financial resources. This shortfall results from increased investment costs, low rates of economic growth and an array of fiscal constraints, including the public debt build-up caused by the COVID-19

pandemic. Securing required financing and fiscal space is possible, however. It requires improving efficiency in public spending and tax mobilization, optimizing debt portfolios and exploring innovative financial instruments. Much depends on reforms at the international level to steer more inclusive and efficient development cooperation.



## A context of urgent needs and fiscal constraints

Global economic and geopolitical uncertainties, the lingering repercussions of the COVID-19 pandemic, climate disasters, conflict and recent interest rate hikes have all heightened pressure on public budgets that fund that fund steps to achieve sustainable development and climate goals. This situation is occurring against a backdrop of decelerating investment and growth as far back as the 2008–2009 global financial crisis, with few signs of a meaningful improvements ahead. Exports from developing countries have only increased by around 3 per cent a year since the financial crisis, compared to 15 per cent annually before that point.

The *Debt and Fiscal Outlook Report for the Arab Region*, the first report of its kind for the region, takes a comprehensive look at different finance flows, including debt, domestic resources and emerging innovative instruments, with an emphasis on achieving greater efficiency to preserve and enlarge fiscal space. The report is intended to help policymakers become better positioned to meet current and future challenges through greater fiscal and economic resilience, and more inclusive development overall. It also seeks to contribute to discourse, including globally, on sustainable finance and the

institutional capacities and policy frameworks that underpin long-term development.

The report recognizes daunting challenges, which vary across Arab countries in different income brackets and those witnessing conflict. Nevertheless, it also identifies opportunities, some of which have not been widely recognized in the Arab region, to secure significant additional financing for sustainable development. The report provides a road map to open fiscal space by better orchestrating different financial flows to form a critical mass of investment. Overall, it finds a potential gain of nearly \$120 billion from applying tools to improve tax collection and public expenditure efficiency, develop evidence-based borrowing strategies to optimize debt portfolios, and access innovative financing instruments.

Reforms at the international level need to support domestic choices and capacities, and redress inequities in access to finance and inefficiencies in how finance is provided. The lead-up to the 2025 Fourth International Conference on Financing for Development and the emerging process at the United Nations to negotiate an international tax convention offer new opportunities to shape long-advocated reforms that are becoming more urgent and, over time, more costly.

## Over \$120 billion annually in additional fiscal space in Arab countries could come from the following:

Improved tax collection by increasing tax revenues from individual and corporate taxes

**\$14 billion**

Greater public expenditure efficiency (at 3 per cent of regional GDP)

**\$100 billion**

Savings from interest payments in market debt (based on a minimum interest rate with equal treatment of peers in 2023):

**\$4 billion**

Savings from interest payments by an increased concessional debt share from official creditors (at the 2010 share of concessional debt in 2022)

**\$122 million**

Greeniums from innovative financing instruments (at 10 per cent of bonds issued in 2023)

**\$127 million**

Savings on debt servicing resulting from debt swaps (at 25 per cent of bilateral debt servicing in 2024)

**\$2.5 billion**

Note: Calculations are based on 2023 values for market debt and 2022 values for official debt and fiscal variables.

For references, see the main report.



## Fixing fiscal inefficiency to unblock more resources

Arab countries vary significantly in their revenue sources, tax systems and public expenditure efficiency. In general, however, the fiscal landscape is marred by low and inequitable revenue generation, compounded by inefficient public expenditures. Both issues must be addressed as they significantly constrain fiscal space and create a cycle of negative reinforcement that undercuts development.

Total public revenues in the region, on average, reached 32 per cent of gross domestic product (GDP) in 2023, compared with 26.5 per cent, on average, for emerging market economies, and 35.5 per cent for advanced economies. Structural inadequacies and economic crises over the past decade have generated high volatility in public revenues. Oil price fluctuations, global economic shocks, the COVID-19 pandemic, limited manufacturing, low value-added services and high shares of informal activities have all played their part.

The share of total tax revenues in regional GDP was 8 per cent in 2020, showing little change since 2010. Despite recent reforms, systemic inefficiencies and substantial leakages have kept tax revenues low. The share of personal income tax in total taxes is generally

below 20 per cent, and wealth taxes constitute a negligible portion of total tax revenues, despite a high concentration of wealth among the top 1 per cent of people. Several Arab countries have revised corporate income tax rates and the tax base, but the level of such taxes in total tax revenues has mostly not improved. As an illustration of the untapped potential of taxation, if Arab middle-income countries boosted the share of personal and corporate income taxes to 6 per cent of GDP, the average for middle-income countries globally, they could generate an additional \$14 billion and distribute tax burdens more equitably.

Goods and services taxes constitute the major share of tax revenues in Arab middle-income countries, a sign of regressive taxation. Reforms have again shown mixed results, suggesting that a primary emphasis on increasing the rate or expanding the tax base has not been efficient. Value added taxes, with multiple tax exemptions and rates, have reduced equity in tax administration, even as their efficiency lags behind global benchmarks. Improving efficiency requires rationalizing exemptions, strengthening tax administration, and enforcing laws to curb tax evasion, informality and non-compliance. This could pay off, as reaching the average efficiency in

value added tax of countries of the Organisation for Economic Co-operation and Development (OECD) would boost revenues by as much as 71 per cent in some cases in Arab countries, which translates into a 3-percentage-point rise in tax as a share of GDP.

Globally, tax collection tends to be higher in countries with larger “social investments”, implying better public services for health, housing and education, and, consequently, greater taxpayer “buy-in”. This suggests that setting medium-term frameworks for revenue mobilization and conducting tax reforms need to be accompanied by investments in quality public services. Yet from 2010 to 2022, the Arab region saw public expenditures decline as a share of GDP from 34.2 to 29.2 per cent. This drop-off was caused by limited fiscal space, inadequate domestic revenue mobilization and external liquidity challenges. High debt-servicing payments now add further pressure.

Expenditure has both declined and shifted in its composition, with a greater portion of funds allocated to operational expenses such as salaries and interest payments on debt. This has reduced investment in building essential infrastructure or enlarging productive sectors. On average, Arab Governments allocate approximately 7.6 per cent of GDP to social expenditures on health, education and social protection as per the latest data, far below the global average of 18.2 per cent. This disparity is particularly striking since total public expenditures regionally are comparable to the global average, meaning a much lower share of the total goes to social policy essentials.

Compared with countries at similar income levels, Arab countries lag on both socioeconomic outcomes and the public expenditures that support them. On measures of the efficiency of general government expenditure and social expenditure, they fall far below global averages. Given constrained fiscal space, greater efficiency is therefore a critical step to improve social development outcomes without raising expenditures. Where outcomes are already satisfactory, countries could achieve comparable results while saving costs. The present report finds that meeting global average efficiency benchmarks could potentially free \$100 billion, around 3 per cent of regional GDP.

Low and inconsistent flows of official development assistance, including in areas critical to the Sustainable Development Goals (SDGs), should provide impetus for comprehensive fiscal reforms. At the same time, international support remains crucial in improving the capacity to finance development priorities effectively. More inclusive governance of the international financial architecture could steer adjustments in financing modalities so they are more attuned to realities in developing countries, including in line with multiple sources of vulnerability that are emerging as the climate crisis escalates.

In tandem, evolving negotiations to establish a United Nations tax convention could provide a more universal and consistent approach to reducing widespread global tax avoidance and profit-shifting, and potentially unblock large new sources of tax revenues from corporations and cross-border transactions.



## Optimizing debt to reduce its burdens

Most Arab countries face significant and multifaceted challenges related to public debt and liquidity, exacerbated by global economic uncertainties and regional instabilities. Systemic challenges include economic crises, rising interest costs, unfavourable interest rate growth differentials, and persistent fiscal and liquidity constraints. These factors have limited

the effectiveness of policy responses, increased debt-servicing costs, and reduced fiscal space for investments in social services and infrastructure. Debt optimization is therefore a critical strategy. It combines cost-effective borrowing to reduce debt-servicing pressures, while maximizing debt contributions to development and climate goals.

The region's public debt escalated to an historic \$1.4 trillion in 2023, compared with \$605 billion in 2010.

This increase is particularly pronounced in middle- and low-income countries, where debt often exceeds 90 per cent of GDP, a potentially significant threat, especially when refinancing costs are high. Debt servicing now consumes significant revenues. Furthermore, the unequal treatment of debtors, adverse credit ratings, and high interest rates have elevated servicing costs for most Arab countries.

The composition of debt has shifted. Arab countries with market access are resorting to increasing shares of market debt in gross government debt. In 2023, middle-income countries raised nearly 47 per cent of gross government debt from the market, up from only 12 per cent in 2010. Growing reliance on market debt can result in higher refinancing costs and greater vulnerability to global financial conditions. In parallel, the importance of debt from official creditors is declining. In middle-income countries, the share of multilateral creditors in total external public and publicly guaranteed debt fell from 33 per cent in 2010 to about 31 per cent in 2023, while the share of bilateral creditors dropped from 36 to 26 per cent.

In low-income Arab countries, most debt still comes from official creditors but the presence of multilateral creditors has declined sharply over the past decade. These countries have increasingly borrowed from commercial banks or other private creditors, together constituting about 20 per cent of debt in 2022, up from around 12 per cent in 2010.

Given increases in debt and interest rates, debt servicing not only absorbs a growing portion of government revenues, but has risen faster than health or investment spending. External debt servicing in Arab middle-income countries took up over 15 per cent of revenues in 2023, compared with about 7 per cent in 2010, and reached a record \$40 billion in 2024. In low-income countries, debt servicing crossed over \$1 billion in 2023–2024, a figure much higher than the pre-pandemic period. For middle-income countries with market access, servicing market debt in both domestic and foreign

currency cost \$214 billion in 2023, or 69 per cent of their revenues.

The difference between rates of interest and growth has spurred escalating debt and exacerbated the risk of debt unsustainability. From 2010 to 2023, the real value of regional GDP rose by about \$791 billion, while outstanding public debt in real terms ballooned by \$880 billion in the Arab region. Although economic growth remained largely below 3 per cent, the cost of borrowing from the market persisted above 5 per cent for both domestic and foreign currency debt in middle-income countries. In high-income countries, the cost of borrowing has been lower, given favourable sovereign credit ratings. Low-income countries have acquired low-interest loans from bilateral and multilateral creditors, with an effective interest rate below 1 per cent, yet their economic growth has largely remained negative.

Fiscal management is key to influencing trends in fiscal balances and public debt. In several countries in the region, however, fiscal and liquidity challenges have led to public debt increasing to over 90 per cent of GDP. This raises concerns about the existence and effectiveness of fiscal rules for handling debt sustainability, especially at a moment of high debt costs.

Several challenges loom in Arab countries dependent on market financing, including rising costs if monetary tightening in advanced economies remains prolonged. While official finance tends to be less volatile, it is prone to surges in geopolitical tensions. Internal conflicts in some countries pose significant constraints on refinancing and drawing new issuances. Another concern is the outstanding maturity of debt in middle-income countries, which is below the average for any comparator group for both domestic and United States dollar bonds. This signals increasing refinancing risks for these countries in coming years, more so as a declining share of official debt prevents them from slowing a trend of declining maturity.

Debt costs vary significantly, but on average are much higher for Arab middle-income countries. They

confront a particular challenge in balancing risks from higher-cost domestic debt with the exchange rate risks associated with foreign currency debt. Furthermore, despite historically low default rates, they face higher borrowing costs than middle-income peers in other regions, based on findings from an artificial intelligence and machine learning analysis. This unequal treatment of sovereign borrowers suggests a need to revise credit-rating methodologies and achieve greater equity in the debt market.

Differences in interest on market debt imply significant room for savings. In 2023, Arab middle-income countries could have retained over \$1.8 billion on interest payments on market debt if the average interest rate for emerging market economies globally was applied. The minimum interest rate for emerging market economies would have lowered interest payments by more than \$4 billion. Even if middle-income countries could decrease interest rates to the lowest level among them in each debt maturity bracket, they could have saved more than \$2 billion on interest payments in 2023. Another way to reduce debt costs would be to maintain higher shares of concessional lending. This would allow middle-income countries to limit the share of market debt, decreasing costs and risks associated with volatile international financial markets.

Reducing the debt-to-GDP ratio is an important challenge for several Arab middle-income countries. In some cases, however, additional debt finance may be necessary. A debt finance strategy can help to stabilize debt in the near to medium term and open fiscal space, based on an accounting exercise to define a debt-to-GDP stabilizing threshold. Such an exercise can estimate how much fiscal space

can be released or generated through debt finance without affecting solvency.

A growing option to limit debt costs involves innovative financing instruments, including green, social, sustainable and sustainability-linked (GSSS) bonds, and programme-based climate and SDG debt swaps. Large-scale adoption of such instruments in the Arab region could deliver significant returns. As an example, for Gulf Cooperation Council (GCC) countries, based on a conservative assumption of a 20 basis-point greenium and with 5 per cent of United States bonds applying these instruments, annual interest rate savings could reach \$15.9 million. This would be in addition to environmental and sustainable development benefits. With more ambitious targets of 50 basis points and 10 per cent, annual interest rate savings would increase to \$79.5 million.

International support needs to complement national efforts to optimize debt portfolios, with some progress underway. Major recent initiatives include the Group of 20 (G20) moratorium on debt servicing, the International Monetary Fund's resilience and sustainability trust to enhance concessional finance, the introduction of disaster-linked debt service suspension clauses, and the credit enhancement linkage taskforce. Yet significant reforms are still needed to increase liquidity measures and concessional lending, make market lending terms more equitable, integrate risk mitigation and credit enhancement into sustainable financing instruments, and reform debt sustainability frameworks to support inclusive and sustainable growth.



## Seizing the promise of innovative finance

In recent years, instruments for mobilizing external finance while advancing sustainable development and climate objectives have emerged, helping to broaden the investor base

and bridge the gap between capital markets and sustainability needs. These instruments include GSSS bonds. Globally, their total outstanding value rose to almost \$1.8 trillion by the end of

2023. Several Arab countries, including GCC countries, have issued green or sustainability bonds or are developing financing frameworks to issue them, indicating increasing prospects for mobilizing finance through this avenue.

Other innovations can help to mobilize finance without adding debt. Debt swaps convert sovereign debt into investments to further development outcomes – a portion of the debt may be either cancelled or exchanged for new, generally more affordable, debt. While conventional debt swaps have often been conducted on an ad hoc basis, and have required significant time and resources, ESCWA has helped to develop new, more readily applied models to release liquidity from external debt repayment for investment in sustainable development. These models foster interministerial coordination and adopt a programme-based approach; a key performance indicator framework helps to achieve national development priorities while contributing to global climate objectives. The initiative fosters efficient cooperation between debtors and creditors as well as traditional development donors in scaling-up investments to achieve the 2030 Agenda for Sustainable Development and the Paris Agreement.

While GSSS bonds and debt swaps are gaining attention in the Arab region, effective implementation requires strengthening specific institutional and technical capacities and processes. Adhering to prudent debt management and improving debt sustainability frameworks help improve access to innovative financing instruments and capital markets. This is particularly crucial for low- and middle-income countries. Credit enhancement and de-risking mechanisms along with grant-funded technical assistance can support access, lower borrowing costs and attract capital, even in cases of below-investment-grade sovereign ratings.

Sustainable or green financing frameworks provide strategic guidance and should be rooted in national priorities, while making strong links to international sustainability principles and indicators. Effective monitoring calls for credible data infrastructure, which can be costly and may necessitate additional funds for countries in the beginning, depending on existing capabilities. The selection of performance indicators and targets should emphasize those that are cross-cutting, with potential impacts on all three pillars of sustainable development. Achieving them can generate a ripple effect and make it easier to pursue even more ambitious sustainability and development goals in the future.



## A seven-point agenda to open fiscal space

Future projections are troubling. Debt burdens are significant in many Arab countries still struggling to develop their economies or those afflicted by conflict. Once relatively flush with concessional loans, debt portfolios are increasingly dominated by costly market borrowing. Domestic resource mobilization remains anaemic and well below global norms. Economic growth forecasts suggest that it will remain relatively stagnant, at levels beneath what will be needed to generate sufficient finance and achieve development and climate goals.

Nonetheless, there are options to restore fiscal space and reignite investment and economic growth. The present report outlines an actionable agenda, including three broad strategies: optimize debt portfolios, enhance the efficiency of public revenues and expenditure frameworks, and increase the use of innovative financing mechanisms and sustainable financing frameworks. In tandem, it urges reforms to the international financial system, so as to make it more equitable and aligned with the efforts of developing countries to realize the 2030 Agenda for Sustainable Development.

## The present report proposes the following seven-point agenda.



### **1 Optimize debt portfolios through prudent debt management:**

Debt optimization should prioritize cost-effective borrowing to reduce debt-servicing pressures, while maximizing the contributions that debt can make to development finance. Striking this balance calls for designing comprehensive optimization strategies based on reducing interest costs, increasing the terms of debt maturities, securing more concessional financing, managing currency risks by diversifying debt portfolios, addressing solvency risks through debt-to-GDP stabilization frameworks, and adopting innovative financial instruments for climate and SDG financing.

The ESCWA Debt Optimization Platform, powered by a machine learning approach, presents an opportunity for Arab countries to assess costs and risks associated with debt portfolios compared with their global peers. The insight it yields can inform debt optimization strategies.



### **2 Strengthen institutional capacity for debt management:**

Enhancing institutional frameworks and technical capacity could support better management of public debt and fiscal policy. This includes investing in robust debt management frameworks that emphasize transparency, consolidating debt data, ensuring accountability and efficiency, and empowering debt management offices through expertise and resources. Technical training on debt data quality and reporting, risk assessment, debt sustainability analysis and innovative financing options is critical.

Improving capacity for data analytics is another important aspect. A macro-fiscal modelling and forecasting tool developed by ESCWA, in collaboration with the United Nations Department of Economic and Social Affairs, offers decision makers an accessible and dynamic interface for evaluating macroeconomic policy scenarios, in a medium-term debt-to-GDP stabilization framework. It supports optimized decision-making to foster growth-enhancing social expenditures, while maintaining macroeconomic stability and debt sustainability.



### **3 Enhance liquidity and concessional financing by reforming the international financial system:**

Reforms of the global financial system should seek to better support the development needs of vulnerable countries, while promoting financial stability and resilience. A more efficient, inclusive and equitable system requires faster debt solutions and more grants and concessional loans with lower interest rates and longer repayment periods, for both middle- and low-income countries.

Reforming debt sustainability assessment frameworks and adjusting sovereign credit rating methodologies to link debt to long-term development outcomes are both central to greater equity and efficiency, including by lowering borrowing costs. Enhancing liquidity requires significant changes, leading to new, larger and more equitably distributed issuances of special drawing rights as a reserve asset.



### **4 Promote innovative financing instruments for sustainable development:**

Strengthening national institutional frameworks and enhancing the preparedness of debt management offices could facilitate access to innovative financing instruments, such as GSSS bonds and programme-based debt swaps. Through these, Arab countries could tap a growing pool of global capital, reduce borrowing costs, and fund critical projects to address climate change and achieve the SDGs.

## 5

### **Improve efficiency in domestic resource mobilization to optimize revenues:**

Greater efficiency in domestic resource mobilization could both enhance fiscal space for development and reduce dependency on external financing. Comprehensive tax system reforms should aim to increase progressivity, cut reliance on indirect taxes and rationalize exemptions. Targeted measures to combat tax evasion, especially among high-net-worth individuals and corporations, should accompany efforts to improve administrative efficiency.

## 6

### **Enhance public expenditure efficiency to increase spending effectiveness:**

Enhancing public expenditure efficiency would expand fiscal space and make the most of limited resources for development. Improving efficiency depends on reducing leakages, optimizing resource allocation, better targeting public services, and prioritizing investments in social services and infrastructure over consumption expenditures. One important policy consideration entails rationalizing subsidies, particularly for energy and food, so they reach vulnerable populations effectively, while minimizing leakages.

The dynamic digital Social Expenditure Monitor dashboard developed by ESCWA helps Arab countries to assess the equity, efficiency and effectiveness of public expenditures. It can also help devise strategies to reduce wasteful spending, while optimizing the allocation of public expenditures to achieve high-impact development priorities.

## 7

### **Address debt vulnerabilities in conflict-affected and low-income countries:**

Conflict-affected and low-income countries at high risk of debt distress or those seeking debt restructuring require tailored support. This could include providing technical assistance to improve fiscal and debt management, restructuring existing debt, and leveraging international partnerships for post-conflict economic recovery and the reconstruction of infrastructure and essential services. Securing debt relief or debt service moratoriums for countries in conflict, such as the Sudan, the Syrian Arab Republic and Yemen, is imperative.



## **Towards a renewal of development investment**

The policy recommendations set out in this report offer a comprehensive road map for the Arab region to enhance fiscal resilience, achieve debt sustainability, and unlock new sources of financing for sustainable development. By integrating climate and sustainable development principles into fiscal planning, Arab countries can create more space to address pressing environmental

and social challenges, and accelerate growth and development in the longer term. Increasing the efficiency of domestic resource mobilization and expenditure, optimizing debt portfolios and applying innovative financing mechanisms are strategies that collectively provide a comprehensive approach to building a more sustainable and inclusive future.

For references, see the main report.



The Debt and Fiscal Outlook Report for the Arab Region provides a comprehensive analysis of different flows of finance – domestic resources, debt and innovative financing instruments – that can expand fiscal space to support sustainable development. The report recognizes that current financing challenges are immense. However, it also demonstrates how the region could tap significant additional resources.

Rising debt burdens, interest rate hikes, inefficient expenditure and crises all weigh on public budgets. Such constraints are compounded by limited access to concessional finance and systemic global inequities. Together, these issues are steadily eroding essential services, impeding growth and increasing inequality.

To ease fiscal strains, the report presents a package of recommendations aimed at both national and international actors. Measures encompass domestic reforms to improve equity and efficiency in public spending, enhance tax mobilization, optimize debt portfolios and increase the use of innovative financial instruments. In tandem, the report urges reforms to achieve a fairer global financial system. This requires steps such as reorienting credit rating methods and debt sustainability frameworks to support public investment that is critical for growth and inclusive development.

Implemented together, report recommendations offer a comprehensive roadmap for the Arab region in its quest to achieve fiscal resilience, ensure debt sustainability and unlock new sources of financing for sustainable development.

