INVESTING IN HUMAN CAPITAL FOR A RESILIENT RECOVERY:

The Role of Public Finance

June 2021

Main Messages

- Despite important progress, significant human capital deficit persisted before the pandemic and a durable recovery hinges on restoring human capital while bolstering service delivery systems to build, protect and utilize it
- Unless addressed with decisive investments, the scars of the COVID-19 shock on human capital and future productivity could become permanent
- This calls for ensuring the adequacy, efficiency, and sustainability of public spending toward human capital outcomes during periods of fiscal tightening and reimagined service delivery systems in a digital world
- Strengthening governance will be critical to ensuring that spending has impact on human capital outcomes and restoring citizen trust
- Securing resources for human capital involves placing human capital outcomes at the center of the budget process and prioritizing expenditure that contributes to human capital accumulation and utilization
- Raising domestic revenues, debt restructuring and relief, and planning for future crises

CHAPTER 1

Human Capital for Recovery and Resilient, Inclusive Development

Key Messages

- Human capital is a key driver of growth that comes with substantial positive externalities and builds a rationale for rethinking the role of public finance in human capital investments.
- The COVID-19 pandemic has unleashed a global health emergency and an unprecedented economic crisis, with impacts on multiple fronts from health, education, and nutrition to jobs, gender equity, and socioeconomic equality—impacts that have exacerbated preexisting human capital deficits and threaten to roll back a decade of progress in human capital accumulation.
- By prioritizing human capital investments and improving the efficiency of the underlying delivery systems and institutions, public finance can not only help drive a green, resilient and inclusive recovery from COVID-19 but also provide a foundation for future productivity and growth.

Human Capital is key for Growth but requires Public Finance in the Recovery and Beyond

- **Human capital – the knowledge, skills, and health that people accumulate throughout their lives, enables them to realize their potential as productive members of society – is critical to the development of individuals and communities and to countries' economic growth.**
- **Human capital accounts for two thirds of total wealth globally and is a primary driver of growth in an increasingly integrated world** (World Bank, The Changing Wealth of Nations, 2018).
- **The Human Capital Index (HCI) measures productivity looking at prospects for children** *How much human capital can a child born today expect to acquire by age 18, given the risks to poor health and poor education that prevail in the country where she lives?*
- **There are large rates of return and multiplier effects from human capital investments.** Public finance can create the environment for leveraging the private sector (as well as development assistance and remittances) in the expansion, adaptation, and utilization of human capital for the recovery and beyond.
- **Public finance for human capital is crucial to addressing COVID-19 crisis impacts, supporting a resilient recovery and generating positive externalities**

COVID-19 is expected to reverse a decade of hard-won human capital gains with long term consequences for equity and growth

Health & Nutrition

130 million more severely malnourished in 202 (WFP)

Up to **45%** and **39%** increase in under-five and maternal mortality per month, respectively, in low- and middle-income countries (lancet)

10%, 20% & 36% increase in HIV, TB and malaria deaths, respectively (Imperial College London)

Widening disruptions in medical supplies for mothers and babies in **75%** of 36 countries surveyed (GFF).

Education

1.6 billion students out of the school in April 2020 (close to 720 million today)

10 pp increase in learning poverty (from 53% to 63%) and **0.6** additional year of quality adjusted schooling lost

$10 trillion lost earnings for the global economy because of lower learning

10 million children are likely to drop out of basic education

Social Protection & Jobs

340 million jobs lost in Q4, particularly in sectors with high female concentration (ILO)

1.6 billion informal workers' livelihoods at risk – nearly half the global workforce

20% projected drop in remittances (KNOMAD), WB)

18 million more extreme poor in fragile and conflict affected states

143-163 million more extreme poor projected by end 2021

Gender Equality

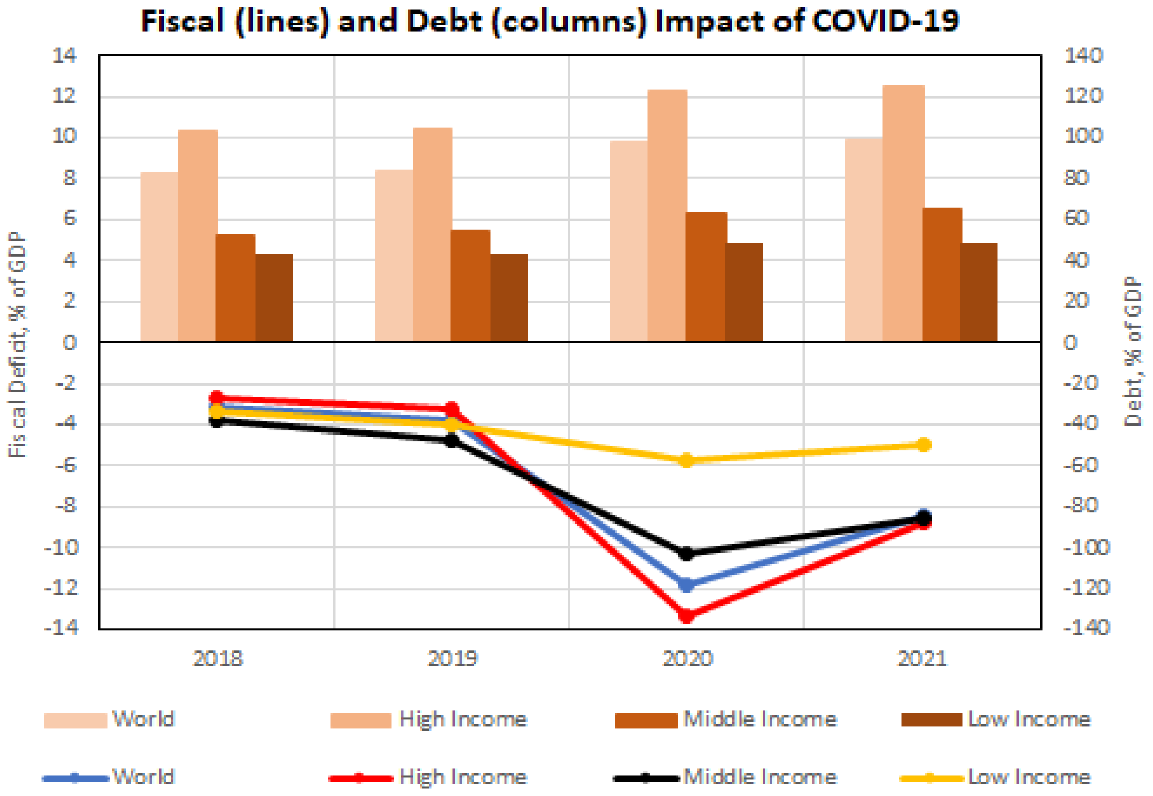
1.3 million more child marriages b/n 2020-2030 (UNFPA)

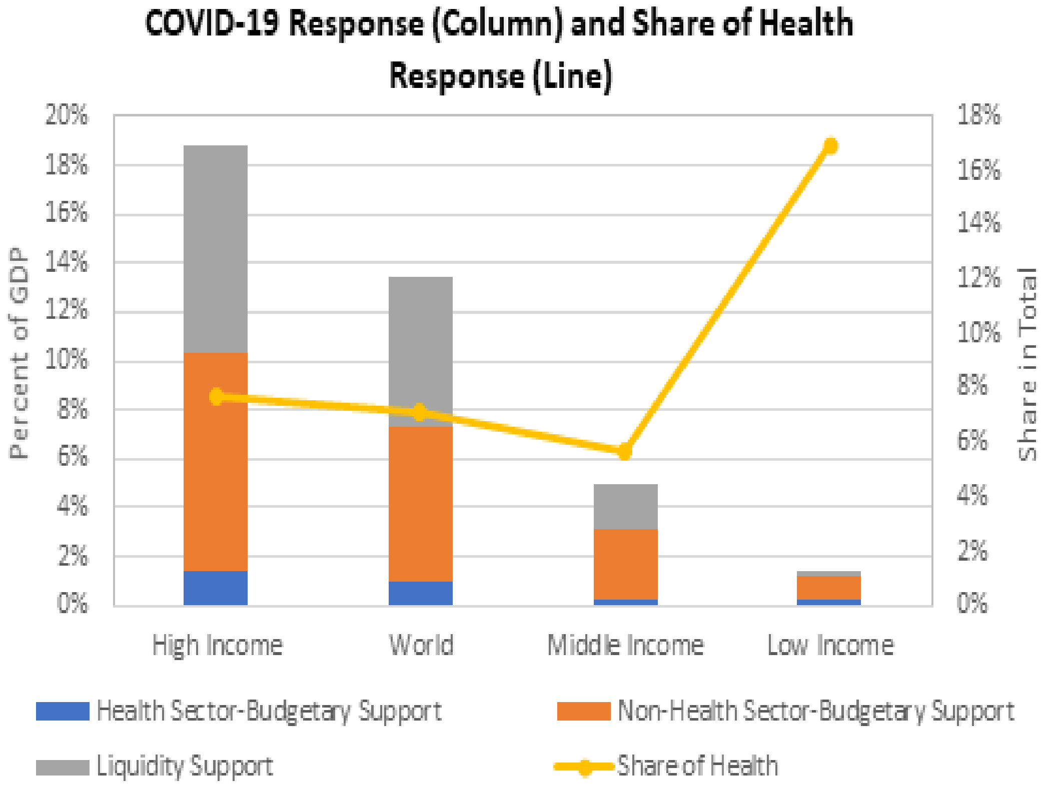
31 million additional GBV cases (UNFPA)

47 million women losing access to contraception, leading **7 million** unintended pregnancies (UNFPA)

Women spend **3 times** the amount of time on unpaid care than men (ILO. 2018).

The fiscal impacts of the COVID-19 crisis are severe





Source: World Bank Staff, based on GEP, 2021 (panel a) and based on IMF Fiscal Measures Database, 2021 (panel b).

Investments in human capital are central to a resilient, inclusive, sustainable recovery

- **Human capital agenda can make Green, Resilient and Inclusive Development (GRID) people-centered and GRID can help human capital agenda drive *integrated* policy and institutional reforms for building, protecting and utilizing human capital**

- **How human capital agenda can contribute to GRID:**
  - GREEN:
    - Family planning can have a positive impact on resource use, lowered environmental damage and lower land fragmentation.
    - Safety nets enable reforms of oil, carbon or utility subsidies to transition to clean energy.
    - Skills development for low carbon jobs energy for employment and public works and economic inclusion programs support adaptation and mitigation.
  - RESILIENT:
    - Those who have good health and nutrition, relevant and adequate education, savings and alternative livelihoods, as well as a safety net for when things go wrong, are those that can weather a climate shock or pandemic.
    - Service delivery systems that are adequately staffed and supplied, adaptive and shock-responsive will be able to weather the next crisis.
  - INCLUSIVE:
    - Quality education, healthcare and safety net programs must reach the poorest and address the needs of those most vulnerable including people with disabilities.

CHAPTER 2

Public Spending to Build, Protect and Utilize Human Capital

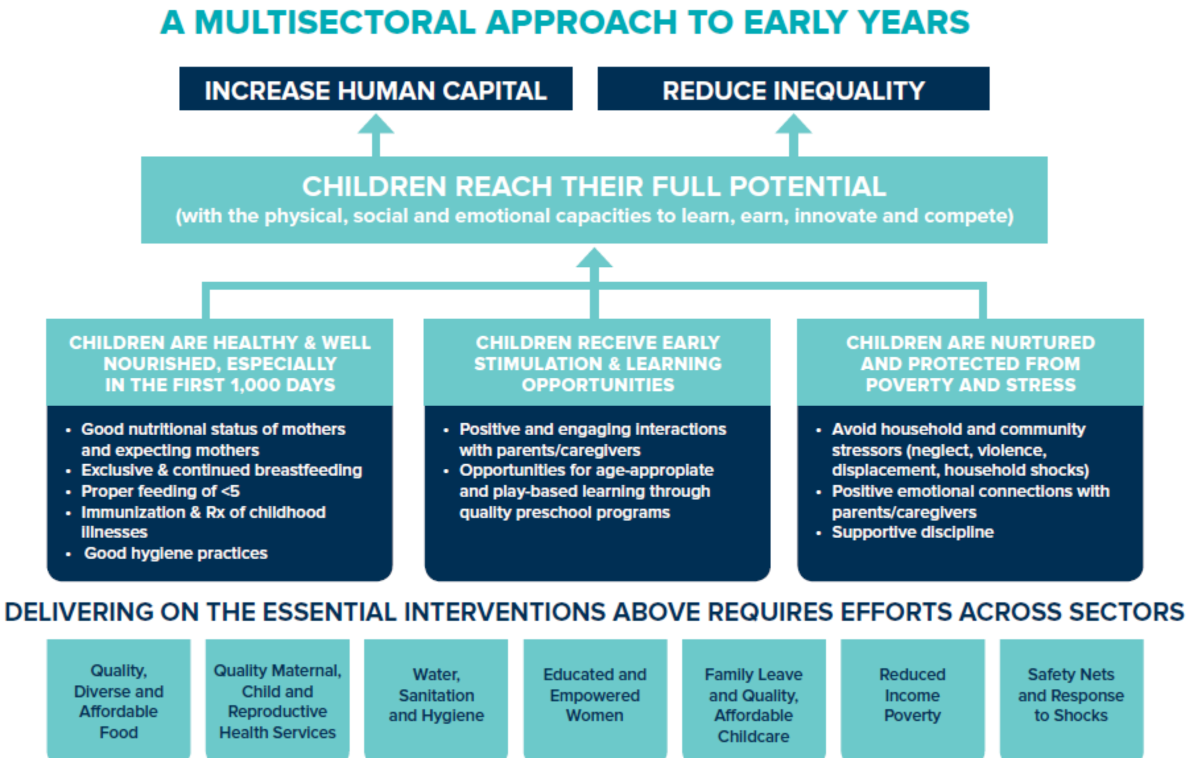
Key Messages

- An outcome-oriented expenditure framework helps identify a coherent set of pro-poor, high-impact expenditure programs across sectors based on evidence and country contexts.
- To reduce permanent human capital losses due to the COVID-19 crisis, the immediate priorities are to restore health, protect young children from malnutrition and other harm, bring children back to school and recover learning losses, prevent the "scarring" of youth, and support labor income opportunities.
- Further improvements in universal health coverage, early-childhood development, learning, social protection and women's economic empowerment can contribute to an inclusive, resilient and sustainable recovery.
- Recent innovations and technology can help strengthen service delivery systems.

A human capital outcome-oriented framework for public expenditure

- **Considerable funding gap even before COVID**
  - Low-income countries would have to double education spending to achieve SDGs
- **But more spending doesn't always translate to better outcomes**

- **A multi-sector theory of change on selected HC outcomes can guide expenditure prioritization**
  - Based on global evidence (e.g., Global Education Advisory Panel on "best/good buy" interventions
  - Tailored to country context to identif relevant mix of expenditures/programs



Restoring Human Capital

	Short-term priorities	Medium/long-term agenda
Health	*Control the pandemic* through enhanced disease surveillance and vaccine rollout *Regain people's health* through essential, pro-poor health services (e.g., immunization/child nutrition; maternal/reproductive health; NCD, etc.) and better financial protection (e.g., reducing/eliminating user fees)	*Restart progress toward universal health coverage* (e.g., Mexico increasing coverage from 31.1 million to following the global financial crisis to 55.6 million in 2013) Coverage expansion could extend to long-term unemployed (e.g., Bosnia & Herzegovina) and undocumented migrants and asylum seekers (Sweden)
Education	*Minimize learning losses by* managed continuity of learning, well-planned school re-opening, pro-poor measures to facilitate re-enrollment/retention (e.g., reenrollment/retention campaigns in Madagascar with focus on girls/students at risk; national tutoring program in UK)	*Accelerate learning* (e.g., Kenya's Tusome Program) *and meet future skill needs* (upskilling/reskilling for green jobs)

Restoring Human Capital

	Short-term priorities	Medium/long-term agenda
ECD	*Prevent severe deprivations* (e.g., acute malnutrition, toxic stress) and ensure continuity of access to basic health, complemented with cash transfers and support for parents/care givers	*Develop multi-sector approach to early-childhood development (ECD)* (e.g., Rwanda's ECD strategic plan with child-focused CCTs with coordinated supply of complementary services)
Jobs	*Prevent scarring* through temporary employment subsidies, resumption/expansion of child/elderly care services, measures to allow students to stay in school longer, alleviation of firms' cashflow (e.g., loan payment deferral in Pakistan; tax payment deferral in Russia), expansion of social assistance to low-income informal workers' households and cash-for-work	*Boost training programs* (esp. for green jobs) and *empower women* (e.g., eliminate gender-discriminatory laws and regulations – Pakistan allowing women to register businesses in the same way as men)

Managing Public Finances for Results

- **Harnessing technology to:**
  - Maximize the benefit of complementary, multisector actions
  - Provide new services (e.g., digital therapeutics for mental health) or transform the way services are delivered in a people-centered way
- **But considerable investments in digital infrastructure**
  - With private sector playing a large role;
  - Under robust regulations (e.g., cybersecurity standards, data privacy & protection); and
  - Strong institutions for efficiency and accountability
- **Health:**
  - "Fit-for-purpose" primary health care with surge capacities in financial/human resources to respond to shocks
- **Education:**
  - Accessible digital learning platforms to allow learning to happen anywhere with an information system to track at-risk students and engage citizens;
  - Financing and accountability mechanisms linked to learning outcomes (e.g., Ceara)
- **Social Protection & Jobs:**
  - Adaptive social protection system coupled with economic inclusion/women's economic empowerment programs
  - Adoption of digital technology combined with skills and regulations for digital jobs to boost labor market resilience

CHAPTER 3

Governance to Translate Fiscal Policies into Human Capital Outcomes

Key Messages

- Achieving human capital outcomes requires policy prioritization, strong coordination across ministries, agencies, and jurisdictions, and an emphasis on evidence-based policymaking. This has been evident especially during the COVID-19 pandemic and will also be the key to recovery.
- The management of government budgets and human resources can benefit from an outcome orientation, with an emphasis on accountability for results, facilitated by digital technologies.
- Governments can renew the social contract around human capital, restoring the trust of citizens through greater transparency and opportunities for citizen participation in policymaking and resource allocation.

Whole of Government Approach and Building Trust

- **Achieving human capital outcomes requires:**
  - **Policy prioritization**: selectivity is key and can be aided by evidence-based decision-making process (i.e. via delivery units, performance tracking systems, policy dashboard)
  - **Strong coordination across ministries, agencies, and jurisdictions**: eliminate policy contradictions, sharing and avoiding duplication between different ministerial budgets, regular tracking of inter-agency goals.
  - **Incentives and capacities** through the entire service delivery chain

- **This has been evident especially during the COVID-19 pandemic and will also be key to recovery (i.e. Republic of Korea, Singapore, and Taiwan, Province of China).**
- **Governments can renew the social contract around human capital, restoring the trust of citizens through more transparency and opportunities for citizen participation in policymaking and resource allocation.**

Managing Public Finances for Results

- **Alignment between the budget and the needs of the sector/frontline service providers is critical.**
- **Effective expenditure prioritization requires reconciliation of the cost of delivering policy objectives with available resources.**
- **Budgetary decisions are political, yet they can be better informed through a more results-oriented budgeting toward human capital outcomes**
  - Budgeting for results in Peru
  - Fiscal rules that govern the budgeting process and medium-term framework
  - Rethinking the current concept of current and capital spending
- **Once budget is aligned to human capital outcomes, Public Financial Management (PFM) system needs to deliver resources to local end-users.**
  - Challenges include: delayed and unpredictable releases of funds, fragmentation of cash balances, cumbersome procurement, weakness in timely reporting
  - Use of digital systems to improve budget execution
  - Intergovernmental fiscal frameworks (i.e. grants and learning outcomes in Mozambique)
- **Accountability and M&E framework to monitor human capital progress**

Results-oriented Workforce Management

- **Motivation and productivity of the service delivery workforce is a key determinant of human capital outcomes.**
  - Quality of management
- **Digital technologies offer low-cost possibilities for improving the accountability and productivity of service providers**
  - Addressing ghost workers in Nigeria via digital ID system
  - Using smartphone-based monitoring of health workers in Pakistan
- **Digital technologies coupled with "analog complements" are critical to achieving human capital outcomes.**
  - COVID-19 highlighted this for building resilient public sector bureaucracies
- **Private sector participation, together with government regulation and oversight, can improve access and quality of service delivery**

CHAPTER 4

Securing Resources for Human Capital Priorities

Key Messages

- Immediate fiscal pressures imposed by the COVID-19 crisis call for protecting resources for human capital priorities, especially in financially constrained low-income countries.
- Over the medium term, domestic resource mobilization will be a primary source of human capital investments and of a resilient recovery.
- It is important that governments review budgets across and within sectors to cut unproductive expenditures and strengthen fiscal resilience.

Protecting Resources for Human Capital in Times of Crisis

- Fiscal imbalances linked to the COVID-19 shock will entail adjustments, making it crucial to protect spending that supports human capital and longer-term development;
- In many sectors, the easiest budget items to cut are often critical for the continuation of services and defunding them could have immediate and long-term implications on human capital outcomes;
- A granular approach to fiscal adjustment would focus on outcomes and the role of specific spending categories for the efficiency of a specific sector and its overall medium- to long-term social returns;
- Clear planning and program classifications within the budget can enable better understanding across sectors of the impact of spending changes on results beyond the current year.

Mobilizing Domestic Resources for Human Capital

- **Domestic resources will be a primary source for driving a resilient, green and inclusive recovery over the medium term;**
- **Countries that fall short of the 15-percent-of-GDP minimum domestic resource mobilization (DRM) rule of thumb need to increase overall DRM to be able to spend on human capital;**
- **Options include:**
  - Increasing overall revenue collection through broadening the tax base;
  - Improving tax equity where tax burden rises with income or wealth of a taxpayer;
  - Including soft earmarks to provide an additional and ringfenced funding stream for human capital investments;
  - Introducing health taxes to discourage harmful consumption through financial disincentives;
  - Offering incentives to taxpayers for investing in human capital;
  - Introducing environmental taxes that generate health and climate co-benefits.
- **The increased devolution of human capital related spending, essentially education and health, toward local governments highlights the importance of local finances and especially of property taxes.**

Finding Space within Budgets

- **Energy subsidies are an example of how regressive spending that promotes inefficient use of fossil fuels with negative consequences for both the environment and health, can be redirected to serve people:**

  - Egypt successfully reduced fossil fuel subsidies from 7 percent of GDP in 2013/14 to 2.7 percent in 2016/17;

  - The fiscal space was used for cash transfer programs, expand school lunch program, and reallocate resources to health and education;

  - Education spending out-stripped spending on energy subsidies in FY2015;

  - In Indonesia, energy subsidies dropped from 3.2 percent of GDP in 2014 to 1 percent in 2015.

  - In 2014, Indonesia spent US$28.9 billion on energy subsidies. In 2017, this declined to US$7.3 billion, while spending on health reached US$8 billion and on infrastructure US$30.1 billion.

- **Lowering energy subsidies generates large co-benefits, including the reduction of climate risks;**
- **Reallocations within sectoral budget can protect frontline services;**
- **The private sector can be a source of funding of human capital as well as a provider of human capital related services.**

Borrowing, Debt Management and International Support for Human Capital Priorities

- **Commercial and official bilateral creditors need to engage in debt restructuring and relief to protect human capital expenditures and prevent periods of fiscal austerity that can lead to erosions of human capital;**
- **Identifying parts of spending as long-term investments in human capital accumulation enhances the prospects for mobilizing domestic and foreign savings for human capital investments;**
- **International support for human capital remains key, during and beyond the COVID-19 crisis, especially for LICs and the most fragile among them:**
  - In LICs (651 million people), average GDP per capita in 2018 was US$796 and average per capita spending on health is US$40;
  - Hence, in LICs this alone would correspond to 5 percent of GDP for a mere minimum of health spending;
  - For many of these countries, this is more than half their domestic revenue collection;
  - Therefore, these countries require protracted and at scale international support.
- **Where possible, streamlining human capital spending within the rules of sovereign wealth funds (SWF) can help with both sheltering this spending from downturns and planning over the medium term.**

Looking Ahead: Reducing the Risk and Impacts of Future Crises

- Strengthening countries' resilience to future crises will involve investments in both risk reduction and risk mitigation;
- Reforms can be introduced that will decrease the probability and severity of future crises;
- Preparedness for mitigating future crises involves investments in response systems for a range of crises, from pandemics to natural disasters and economic shocks;
- Strengthened service delivery systems can help to prevent the worst impacts of crises and formulate agile responses once crises occur;
- As countries look to build resilience to future shocks, financial instruments need to be prepared so that they can be deployed rapidly with the onset of future crises.

Next Steps and Questions for Discussion

Next steps

- Internal/external outreach/engagement plan
- "How-to" notes to translate the paper's messages into practical actions

Questions for discussion

- What opportunities might there be to use this framing to advance in country dialogue?

Thank you

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