

EXECUTIVE SUMMARY

Global growth remains lackluster, and public debt is high and rising, with increasing defense spending, aging populations, and higher interest rates putting additional strain on public finances. Governments should take decisive action to strengthen economic growth and rationalize public spending to improve living standards and alleviate fiscal pressures. This *Fiscal Monitor* explores how enhancing spending efficiency and strategically reallocating resources—particularly toward infrastructure, human capital, and research and development—can improve growth prospects, without increasing overall spending. By implementing these expenditure reforms, governments can not only strengthen economic resilience but also pave the way for a more prosperous future for their citizens.

The potential for reform is substantial. Over the past several decades, public investment as a share of total spending has declined, and expenditure on public education has stagnated. Wage bills are significant, and public sector wages often exceed those in the private sector, distorting labor markets. Rigid spending structures, especially in advanced economies and large emerging market economies, limit the scope for meaningful reform. Despite progress since the 1980s, spending efficiency gaps persist. These gaps are the difference between actual outcomes of public spending and the best outcomes achievable with the same resources. Efficiency gaps currently stand at about 31 percent in advanced economies, 34 percent in emerging markets, and 39 percent in low-income developing countries.

Countries can improve growth prospects by redirecting spending toward areas that increase the economy's productive capacity. Insights from a new global data set on spending efficiency, combined with analyses of reform episodes and model simulations, demonstrate substantial gains in output. For instance, increasing infrastructure investment by 1 percent of GDP, while keeping overall spending constant by cutting government consumption (such as administrative overhead), is associated with long-term

output increases of about 1½ percent in advanced economies and 3½ percent in emerging market and developing economies. The long-term benefits from increasing education spending are even larger, estimated at about 3 percent in advanced economies and 6 percent in emerging market and developing economies.

Enhancing spending efficiency can magnify these gains substantially. Closing efficiency gaps has the potential to increase output by an additional 1½ percent in advanced economies and 2½ to 7½ percent in emerging market and developing economies over the long term, with faster progress yielding even greater benefits. Implementing complementary policies—such as combining investments in human capital and infrastructure in emerging market and developing economies and integrating spending on public education and research and development or fostering technology diffusion in advanced economies—can amplify these positive outcomes even further.

To increase spending efficiency, countries should make institution-building reforms a priority. These reforms should focus on combating corruption and enhancing transparency and accountability through robust mechanisms to control expenditure and publish budgets. Processes for public procurement must be competitive and transparent, especially in advanced economies, where they account for a large share of GDP. Strengthening systems for the management of public investment is critical, with opportunities to enhance project appraisal and ensure maintenance funding. In all countries, improving budget processes is also essential to optimize spending efficiency. Implementing multiyear frameworks for budgeting can effectively connect strategic spending plans with annual budgets. Countries should also leverage digitalization to improve public finance operations and service delivery. Expanding private sector involvement by outsourcing noncore functions of government and collaborating on investment projects can improve spending efficiency and create budgetary space, although this requires careful management of fiscal risks.

Reforming pension and health care systems to ensure their sustainability can create space for growth-enhancing spending. Aligning public sector wages with private sector benchmarks is crucial to effectively manage public wage bills. Better targeting social assistance programs, including consolidating fragmented initiatives in low-income developing countries, can also alleviate fiscal pressures. There need not be a trade-off between pro-growth and equitable spending; in fact, the evidence in this chapter indicates

that public spending on investment and education can effectively reduce income inequality.

Governments should leverage tools such as spending reviews to optimize existing resources and ensure that public money delivers lasting benefits. To maximize impact, they should design these reviews thoughtfully and integrate them into budgetary processes. Countries with limited capacity can benefit from incorporating elements of frameworks for reviewing spending, such as benchmarking and performance indicators.