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Leading questions on sustainable fiscal space for social protection

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Question

What are the essential building blocks and foundation that would contribute to a sustainable fiscal space for social protection in the future?

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1. Summary

There is general agreement in the literature that sustainable finance for universal social protection is attainable. Debate persists, however, on the most effective and most efficient measures to expand fiscal space to achieve universal protection. Strategies for domestic resource mobilisation and effective aid spending provide a wide range of options for national governments and donors to combine and sequence fiscal policies in ways that meet the unique economic, social and political conditions of different contexts. This paper briefly explores seven leading questions around the essential building blocks and foundation that would contribute to a sustainable fiscal space for social protection in the future:

- What are the overall costs of universal social protection?
- What are the primary funding sources and funding mechanisms for social protection?
- What are the appropriate sequencing and policy mixes under different fiscal conditions?
- How can social protection financing be gender-transformative?
- How can social protection financing be transformative for people with disabilities?
- How can social protection funding be crisis-responsive?
- What is needed to ensure social protection financing is sustainable in the long term?

The paper is structured around each of these questions and draws on the latest evidence and policy guidance that seeks to respond to them. To capture the breadth of guidance on this topic, a broad search of academic literature, international development agencies' guidance documents and non-governmental organisations' (NGO) reports was used. The questions explored in each of the subsequent sections are those that were found to be most prevalent across the range of policy recommendations.

In light of the heightened demand on social protection systems due to the Covid-19 pandemic, questions surrounding the sustainable fiscal space for universal social protection have risen to the top of many national governments' agendas. Emergency measures are being adopted to fill social protection gaps and ongoing measures are being reviewed and adapted in response to shortcomings of existing systems to response to the crisis. The questions reviewed by this paper are therefore being debated and reinterpreted at the present time, and new evidence is likely to emerge based on learning from the ongoing crisis.

Much of the policy guidance on the essential building blocks of sustainable social protection finance identified for this report is informed by achievements made to date in particular contexts, but there is limited discussion of past policy failures and inefficiencies to be avoided. Where past failures are noted, as in the case of privatisation, there is often little documentation of these experiences. Further exploration and contextualisation of potential pitfalls could be useful to better future-proof new and ongoing measures. There are also some areas with significant potential to expand fiscal space for social protection that are widely noted in the literature but for which policy guidance appears to be weak and expectations on their feasibility appear low. These include the elimination of illicit financial flows, which could be used fill the financing gap for social protection, and appropriate financing mechanisms and allocations for people with disabilities. Further research may be needed to-reimagine these questions and to push policy guidance in these areas in new directions.

2. What is the overall cost of social protection?

The ILO estimates the global cost of filling the financing gap for universal social protection coverage to be US$792.6 billion in 2019 (ILO, 2019, p. xv). Upper middle-income countries (UMICs) make up nearly three quarters of this gap, largely driven by financing gaps in Latin America and the Caribbean, followed by lower-middle income countries (LMICs) (23%) and low income countries (LICs) (4%). The smaller share of finance needed in LICs is partly explained by their smaller populations and lower costs of benefits (Durán-Valverde et al., 2019, p. 20). Though LICs make up a smaller share of the total financing gap, these economies have the highest gap as a percentage of gross domestic product (GDP) on average (5%) compared to LMICs (1.9%) and UMICs (1.4%) (Durán-Valverde et al., 2019, p. 20). This indicates that the financing needed for social protection is greatest in LICs relative to the size of their economies.

There is a strong relationship between social protection spending and GDP per capita, though there is significant variation within country income categories and geographic regions (Durán-Valverde et al., 2019). LICS spend 1.3% of GDP on social protection on average compared to 2.4% in LMICs and 7.9% in UMICs. LICs and MICs in Europe, Latin American and the Caribbean and Central and Western Asia spend over 8% of GDP on social protection while Oceania, South-Eastern Asia, sub-Saharan Africa and South Asia spend less that 3%. In sub-Saharan Africa, social protection spending ranges from 7.4% in Mauritius to 0.1% in Chad, in Latin American spending ranges from 13.2% in Brazil to 0.7% in Belize and in Asia and the Pacific it ranges from 10.1% in Iran to 0.1% in Bhutan (ILO, 2017).

The widely held view that universal social protection is too costly for LICs has been challenged by a number of recent studies and by achievements in lower-income settings (Cichon, 2018; Durán-Valverde et al., 2019; Herman, 2018; ILO, 2017; ILO, 2018). In response to the longstanding debate on whether LICs could sustainably finance universal social protection, a number of estimates have been generated to show that the additional funds required to fill the financing gap are attainable for most countries using domestic resources. The Global Coalition for Social Protection Floors (GCSPF), a network of over 90 civil society and trade union organizations, produced an index showing that around half of the 150 countries measured could close the funding gap by allocating an additional 2% of GDP and 80% would require less than 5%. (Cichon, 2018, p.15). The index does however reveal 13 countries that require significant external funding as they would require an additional 10% of GDP or more (Bierbaum et al., 2017, Herman, 2018). Further evidence is provided by the fact that at least 23 LICs and MICs have achieved universal social protection coverage for at least one social protection benefit (Durán-Valverde et al., 2019). For example, over 20 countries and territories have achieved universal or near-universal old-age pension coverage including Bolivia, Lesotho, Timor-Leste and Zanzibar (ILO, 2017).

3. What are the primary funding sources and funding mechanisms for social protection?

There are eight widely discussed strategies to expand fiscal space for social protection: (i) increasing tax revenues; (ii) expanding social security coverage and contributory revenues; (iii) eliminating illicit financial flows; (iv) reallocating public expenditures; (v) using fiscal and central bank foreign exchange reserves; (vi) managing debt (vii) adopting a more accommodating macroeconomic framework; and (viii) increasing Overseas Development Assistance (ODA) and

transfers (see Durán-Valverde et al., 2019; ILO, 2018; Ortiz et al., 2019). The remainder of this section briefly explores (i), (ii) and (iii) and (viii); further elaboration on (iv), (v), (vi) and (vii) can be found in ILO (2018). A final funding source, private financing, has been found to be ineffective and is briefly explored at the end of this section.

Tax revenues

Increasing tax revenues to generate fiscal resources for non-contributory social protection measures is a leading area of interest among donors, social policy experts and academics (see Bastagli, 2016; Coady, 2018; Ortiz et al., 2019). Policies to expand fiscal space through taxation typically involve altering different types of tax rates (such as income, consumption, real estate, corporate profits, financial activities, imports/exports and natural resources) or strengthening the efficiency of tax collection methods and overall compliance (Ortiz et al, 2017). For example, taxes on mining and gas have been used to finance social protection measures in Bolivia, Mongolia and Zambia, tourism taxes have been used in Ghana, Liberia and Maldives, and high taxes on tobacco have been used in Algeria, Mauritius and Panama (ILO, 2018, p.12).

Tax ratios vary significantly across countries due to the structure of national economies, political constraints to increasing taxes, and different capacities to administer and coordinate tax systems (Moore, 2013). LICs and MICs maintain significantly lower tax ratios than high-income countries (HICs). A World Bank study on the tax capacity of 110 countries found that HICs collect 2-3 times higher taxes at a percentage of GDP than LICs (Lin, 2009, p.5). Notable achievements in increasing tax ratios have been made in some countries: Georgia increased tax revenue by 12.9% of GDP between 2004-2008; Maldives increased by 11% between 2011-2015; Dominica increased by 7.5% between 2002-2006; and Ghana increased by 7.3% between 2000-2004 (Coady, 2018, p. 25).

Expanding social security coverage and contributory revenues

Social insurance schemes funded by workers and employers are considered a desirable and necessary strategy to sustainably finance social protection and to achieve higher levels of protection beyond basic benefits (Durán-Valverde et al., 2019, p.22). Some countries have made significant progress in increasing contributory revenues such as China, Costa Rica, Paraguay and Tunisia, where social contributions represent over 60% of social protection finance. Durán-Valverde et al. (2019, p.22) estimate that social security contributions could amount to 6.3% of the GDP to LIC sand MICs if those currently below the expected average coverage were to increase to the expected level, leading to a net gain of 1.2% of GDP.

Expanding social security coverage to workers in non-standard forms of employment and the informal sector remains a significant barrier in many LICs and MICs. The informal sector is characterised by self-employment, low-skilled labour and multiple and volatile income sources which are difficult to verify and administer (Coady, 2018). The link between social contributions and informality is considered one of the most controversial issues in social protection financing, leading to divergent policy recommendations (ILO, 2019, p.58). Some innovations in social security coverage for the informal sector include subsidised social contributions, simplified tax and contribution collection mechanisms, and design adaptations for low-income self-employed workers, small and micro-enterprises, domestic workers and workers in the agricultural sector (ILO, 2018).

Illicit financial flows

Combatting money laundering bribery, tax evasion and trade mispricing could significantly increase the fiscal space available for social protection in LICs and MICs. An accurate value of illicit financial flows is not available but the range of estimates aligns with the estimated finance gaps for social protection and is estimated to be larger than total aid disbursements. For example, the Joint African Union Commission/United Nations Economic Commission for Africa (AUC/ECA) estimates that lost revenues to Africa amount to more than US$50 billion dollars per year (AUC/ECA, 2019) while the finance gap for social protection in sub-Saharan Africa is estimated to be US$49.5 billion (Durán-Valverde et al., p.20). Strategies to tackle illicit financial flows include cracking down on money laundering, bribery, tax evasion, trade mispricing and other financial crimes (ILO, 2018, p.13)

Illicit financial flows are increasing despite a number of national and international initiatives to combat them (AUC/ECA, 2019). One of the primary challenges in this area is the cross-border nature of these crimes and the lack of coordination among national and international actors. An AUC/ECA investigation into illicit financial flows cites a lack of capacity within Africa government agencies to monitor and take measures to combat these crimes as one of the leading cause for their increase The present Covid-19 crisis is also expected to lead to an increase in organised crime, which coupled with lower tax revenues due to reduced economic activity, is likely to have a significant impact on the fiscal space of many countries in the short term (Herbert & Marquette, 2020; Vaspar et al., 2020).

ODA and transfers

In addition to domestic resources, donor funding has been used to fund many social protection programmes in LICs, particularly in Africa (World Bank, 2018). It has been argued that ODA is the primary global income redistribution mechanism, making it a justifiable first option for expanding fiscal space for LICs in particular (Ortiz et al., 2017, p.22). Some of the largest social protection programmes in LICs and MICs have involved significant donor funding such as the Progressa programme in Mexico and the Productive Safety Net Programme in Ethiopia. ODA spending on social protection remains relatively low by comparison to other sectors, however, at less than 1.4% in 2016 (ILO, 2019, p.179)

There is significant debate and divergent approaches surrounding social protection finance among donor agencies. "Significant areas of contestation exist… particularly between the UN and World Bank with regard to addressing inequality and redistribution, universal versus residual (targeted) approaches, risk and resilience and the concept of graduation, as well as institutional priorities and design preferences" (OECD, 2019, p.12). By extension, concerns have been raised about a lack of coordination among donors, leading to the establishment of the Social Protection Inter-Agency Cooperation Board (SPIAC-B) in 2012 at the behest of the G20 Development Working Group (OECD, 2019). Additional concerns relate to the favouring of short-term, sectoral-specific funding among donors which impacts on the sustainability of these programmes (Barrientos, 2004, p.9).

Private funding

Evidence from a range of countries indicates that pro-private structural reforms in social protection have led to adverse effects (ILO, 2018, p.9). Privatisation policies have been reversed in Argentina, Bolivia, and Kazakhstan due to failures to increase coverage and benefits,

the transfer of systemic risks to individuals and worsening fiscal situations (ILO, 2018, p. 9). A number of guidance documents promote the need for private investment to sustainably the finance gap for social protection (see for example Durán-Valverde et al., 2019), though limited guidance is offered on how this might be achieved to greater effect. Innovations in public-private partnerships have explored more recently, such as Colombia's Social Impact Bond where investors are supporting skills training and job placements for poor urban residents (Ortiz et al., 2019, p.25).

4. What are the appropriate sequencing and policy mixes under different fiscal constraints?

There is consensus in the literature that a combination of financing mechanisms is needed to meet the unique fiscal constraints of different contexts. Multiple sources encourage national social dialogue with government, workers, civil society academics and international agencies to agree a politically and economically optimal mix of social protection funding policies (see for example ILO, 2018; World Bank, 2012a). Table 1 depicts the heterogenous mix of policies reviewed in section 3 across selected country contexts. Complimentary policies and institutions are also seen as important to the design and sustainability of social protection financing, as are informal social and community networks (World Bank, 2012b).

Table 1: Matrix of fiscal space strategies, selected countries

	Bolivia	Botswana	Brazil	Namibia	South Africa	Thailand
Re-allocating public expenditures					X	X
Increasing tax revenues	X	X	X	X		X
Expanding social security contributions			X	X	X	X
Reducing debt/debt service	X	X	X		X	X
Curtailing illicit financial flows						
Increasing aid				X		
Tapping into fiscal reserves	X	X	X			
More accommodative macroeconomic framework	X		X			

Source: Adapted from Ortiz et al., (2017, p. 3)

Combining non-contributory and contributory financing mechanisms is seen to be the most effective way to extend social protection coverage (ILO, 2018, p.8). This typically involves combining social insurance contributions with general taxation for universal benefits such as child or disability benefits, or means-tested social assistance for vulnerable populations lacking contributory capacity (ILO, 2018, p.8). While HICs tend to rely more on contributory measures than LICs, as discussed in section 3, some LICs and MICs have made progress in shifting this balance further towards contributory revenues. Ortiz et al. (2019) suggest analysing a range of national-level fiscal space indicators to determine the feasibility of different policy measures for social protection finance.

Many countries adopt social protection measures in stages, requiring financing decisions to be made with long-term time horizons. Some measures can be implemented in relatively shorter time periods, such as adjusting tax rates and reallocating public expenditure, while others require significant systemic reform and capacity development (ILO, 2019, p.12) For example, the extension of contributory measures requires the development of procedural and administrative systems for monitoring compliance and complimentary programmes to expand coverage in the informal sector (ILO, 2019, p.12).

5. How can social protection be gender-transformative?

Social protection financing mechanisms have the potential to exacerbate gender inequalities if the differential impacts on men and women are not taken into account (ILO, 2018). Levels of social contributions among men and women may differ based on gender norms that lead men and women into different types of employment and the nature of their work may vary over the life course. For example, unpaid care for children, parents and ill family members is disproportionately carried out by women, particularly during women's working years, and needs to be counted towards social protection contributions (ILO, 2018, p.10) Germany, Japan, and the United Kingdom have adopted measures to recognise contributions from care work towards social security entitlements (ILO, 2018, p.10)

Gendered social norms at different levels of fiscal decision-making may also inhibit women's participation in spending decisions (Holmes et al. 2019). The disempowerment of women in political institutions may inhibit the expansion of fiscal space for social protection as evidence suggests that female political leaders are more likely to invest in social sectors and in redistributive policies (Muntaneer & Ng, 2019). Holmes at al. (2019, p.7) also note that "resource allocation decisions are usually made through informal rather than formal institutions, with less visible decision-making processes… yet gender equality activists, and particularly women politicians, often face challenges engaging in these arenas". Emerging evidence on the impacts of Covid-19 in conflict affected areas has found that gender imbalances have deteriorated in some areas, indicating greater need to address systemic gender inequalities (Search for Common Ground, 2020).

6. How can social protection financing be transformative for people with disabilities?

The majority of LICs and MICs fail to adequately fund social protection measures for people with disabilities (Kidd et al., 2019; Oddsdottir, 2014). Only six LICs and MICs invest more than 0.3% of GDP in disability specific social protection measures by comparison to 80% of

HICs that invest 1% or more (Kidd et al., 2019, p .iv). There is limited evidence on the extent to which people with disabilities access social protection benefits due to the lack of disaggregated data to track access by different groups, but some country-level evidence suggests that access is lower for people with seeing and hearing difficulties (South Africa), while in others access appears to be relatively balanced (India) (Kidd et al., 2019, p.iv).

The effectiveness of disability-targeting funding is often curtailed by weak institutional structures designed to administer the funds. Kidd et al. note that "it is common for responsibilities for disability to be relegated to a weak social development ministry and, within the ministry, to be further relegated to a poorly resourced institution" (2019, p.vi). In addition to many design and targeting weaknesses, the authors also point to a lack of awareness and disability inclusive environment with government and social institutions at large, concluding that complimentary policies to promote the inclusion of people with disabilities are also needed.

7. How can social protection be crisis-responsive?

To ensure social protection measures are effective and efficient in the event of a crisis, measures should be in place before the onset of crisis (World Bank, 2012a). Social protection measures are critical for effective crisis response to smooth out consumption and to protect access to basic services for vulnerable groups (World Bank, 2012a). The current Covid-19 pandemic has revealed a high demand on social protection systems in a time of global crisis. In the longer-term, localised crises such as climatic shocks, natural disasters, economic shocks or conflict will continue to threaten LICs and MICs and put pressure on social protection systems.

Funding of social protection measures must be reliable, timely and universal to reduce negative coping strategies employed by households during a crisis (Bastagli et al., 2016; Ulrichs et al., 2017; World Bank, 2012c). For example, rural households in Ethiopia who participated in the Productive Safety Net Programme (PSNP), a large ongoing public works programme, were less likely to sell their livestock to smooth consumption as a result of drought (World Bank, 2012c, p.7). A study of social protection measures for refugees in Jordan found that regular and predictable monthly transfers offered households a reliable income stream that led to reduced negative coping strategies such as child labour (Ulrichs et al., 2017).

Emerging insights from the Covid-19 response indicate that some short-term fiscal measures may be effective in the event of rapid onset crisis. For example, tax deferrals have been used to ease cash flow issues for small business to help retain employment and temporary income support targeted to vulnerable households has been used to smooth out consumption (OCED, 2020). Research from the OECD indicates that temporary short-term fiscal measures to fund relief packages can be useful to limit the risk of pressure from lobby groups to introduce permanent changes to the tax system that may not be beneficial in the long term. (OCED, 2020).

8. What is needed to ensure social protection financing is sustainable in the long term?

Ensuring future social protection costs are economically feasible and anticipating future demands on social protection systems is a challenge for countries in all income categories (ILO, 2018, p.9). Regular revision of future financial demands on a social protection systems and incremental adjustments are encouraged "given that reforms tend to be politically

unpopular, governments -through social dialogue- have the responsibility of anticipating trends and introducing the necessary parametric adjustments to balance the system in a timely way, so as to ensure the current and future adequacy of benefits and sustainability of the system" (ILO, 2018, p.9).

The global coalition for Social Protection Floors warns, however, that fiscal sustainability should not be sought at the expense of social protection coverage (Bakvis et al., 2019). Based on a review of 616 IMF country reports covering 2010 to 2015, the authors point to a number of cases of loan conditionalities and IMF recommendations to divert or limit spending on social protection in the interest of fiscal sustainability. For example, Nicaragua was advised by the IMF in 2018 to enact pension reforms that included reductions in benefits and increases in contributions. The reforms were eventually cancelled following mass protests (Bakvis et al., 2019. p.5)

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