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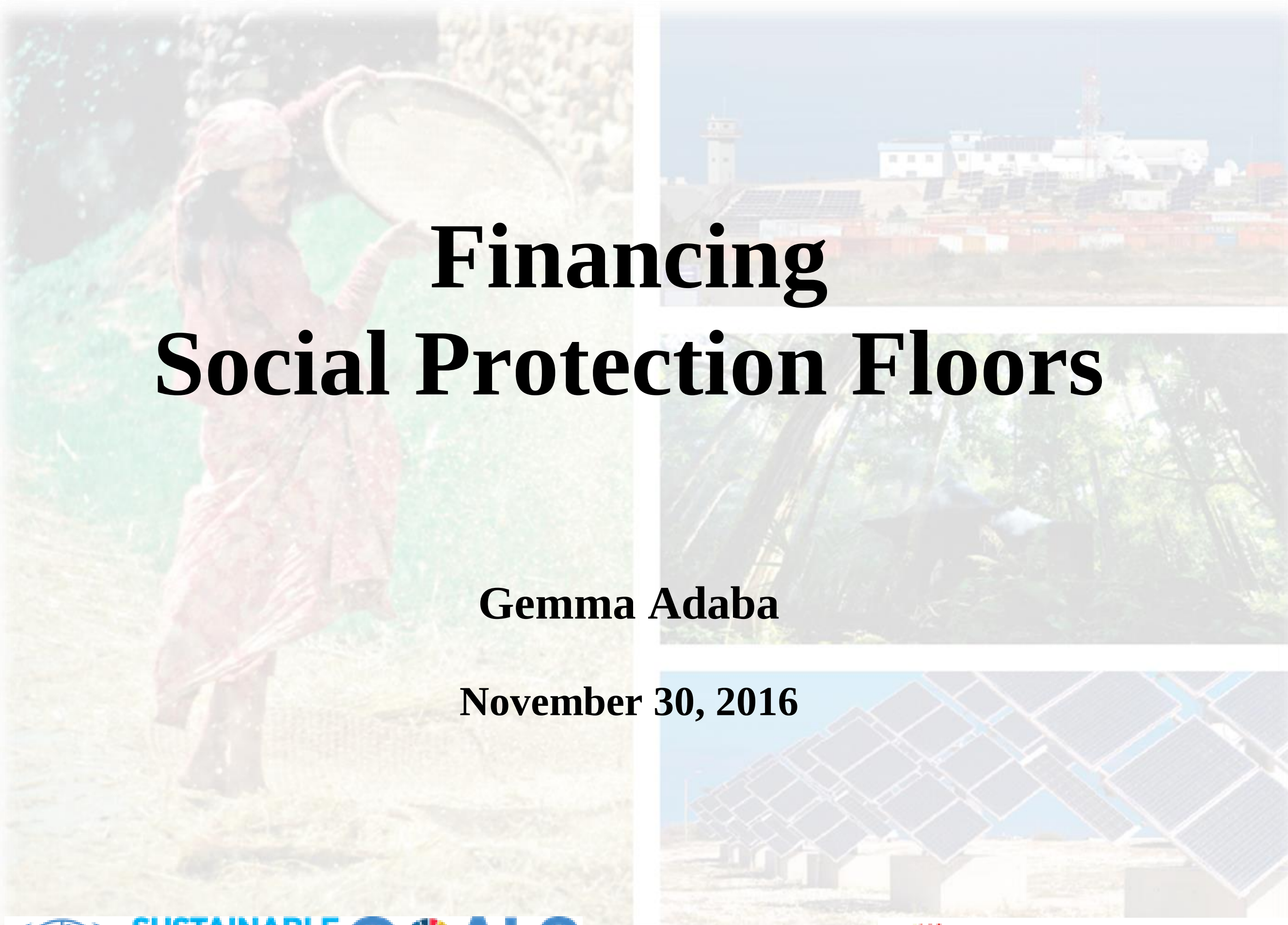

Financing Social Protection Floors

Gemma Adaba

November 30, 2016

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FINANCING SOCIAL PROTECTION FLOORS

Gemma Adaba*
Social Justice in Global Development

Discussion paper presented to an
Expert Group Meeting of the
Inter-agency Task Force on Financing for Development
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* Views expressed are those of the author and not necessarily of the United Nations, ILO or the Inter-Agency Task Force. Cooperation in producing this paper of my co-director of the Financing Social Protection Floors project of SocDevJustice, Barry Herman, and of its Executive Director, Eva Hanfstaengl, are much appreciated. I take responsibility for all errors (contact: adaba@socdevjustice.org).

ABSTRACT

This discussion paper offers a policy context and conceptual framework for an exploratory discussion on financing social protection floors: It reviews a number of salient country experiences in SPF provisioning, highlighting examples of good practice and lessons learned as regards the design and funding of SPFs. It explores the role of international cooperation in supporting national governments as they address the challenges and seek to build and strengthen their SPFs. An annex distils some important principles that should guide discussions on strategies for the mobilization of domestic and international public finance for social protection floors.

SUMMARY OF KEY POINTS

- Despite significant reductions in poverty over the past 15 years, poverty and inequality are still quite persistent in much of the developing world. Realizing the agreed goals for ending poverty and reducing inequality articulated in the 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda requires that high priority be given to social sector programming and expenditure.
- Social protection systems and social protection floors (SPFs), in particular, are central instruments for fulfilment of the sustainable development goals within a gender-sensitive, human rights-based framework.
- Social protection floors are commitments undertaken by governments to all citizens, to guarantee a minimum level of income security that is nationally defined, as well as provision of essential goods and services.
- Results of studies carried out in many middle- and low-income countries attest to the importance of social protection provisioning for reductions in poverty and inequality.
- As regards contingencies covered, many countries have prioritized pension benefits and income security through cash transfers, as well as provision of a broad range of essential services, particularly health and education.
- Thus, SPF programmes are striving to provide minimum protections, but many gaps are evident. Benefits are generally low, and the reach to populations in need is limited.
- Governments need to significantly expand their outlays for social protection if they are to fill the gaps and realize the goal of universal social protection.
- Governments need to expand fiscal space by broadening and diversifying the tax base, and improving the progressivity of taxation; they need to reprioritize public expenditure, thereby significantly increasing resources available for SPFs.

- National dialogue and consensus-building are important to ensure the legitimacy of tax reforms, as is cultivating the concept of solidarity across populations, and indeed, the establishment of national social compacts.
- National tripartite dialogues can be an effective mechanism for consensus-building. They involve governments, trade unions, employers and civil society organizations. Their aim is to develop national consensus on priorities and strategies for building social protection systems and floors.
- There are important areas that should be considered for international cooperation. These include:
  - technical and financial support for institutional and human capacity-building;
  - special interventions to safeguard the ability to honour SPF obligations at times when countries are experiencing economic shocks, or ecological or health crises; supplementing the protection governments can provide from their own resources, for example:
    - Official development assistance (ODA) grants, or loans on highly concessional terms,
    - Introducing contracts for sovereign debt-servicing that delay or reduce or cancel payments under pre-set conditions (such as “sovereign cocos” or GDP-linked bonds),
    - Semi-automatic international lending in adequate amounts on appropriate terms to meet pre-set contingencies, building on the ideas behind existing facilities,
    - Facilitating fair, effective and timely sovereign debt restructuring when necessary.
- Most countries have the means, and can find the fiscal space to strengthen their SPF provisioning with the aim of reaching universal coverage at a nationally agreed minimum floor level, at least during normal circumstances. However, studies suggest that a small number of highly stressed developing countries may require some more sustained funding on ODA terms.

INTRODUCTION - PRIORITIZING SOCIAL PROTECTION

Despite significant reductions in poverty over the past 15 years, poverty and inequality are still quite persistent in much of the developing world. It is estimated that 700 million people were still living in extreme poverty in 2015 as measured by the USD 1.90 per day poverty line.[1] In September of that year, the world's Governments came together to adopt the 2030 Agenda for Sustainable Development and its sustainable development goals (SDGs), making a number of declarations and explicit commitments which warrant in-depth reflection and dialogue as to their means of implementation:

> *We must leave no one behind.*
> *We must reach those furthest behind first.*
> *By 2030 we must end poverty in all its forms everywhere, and reduce inequality within and among countries; and we must promote human rights and gender equality.*[2]

Realizing these aspirations and goals requires giving high priority to social sector programming and expenditure. We advance the argument that social protection systems and social protection floors (SPFs), in particular, are central instruments for fulfilment of the sustainable development goals of ending poverty and hunger, reducing inequality, ensuring healthy lives, providing equitable quality education and promoting gender equality.

We base ourselves, firstly, on the Social Security (Minimum Standards) Convention 102 of the International Labour Organization (ILO), adopted in 1952, which provides a framework for pursuing comprehensive social security and social protection coverage by identifying eight contingencies over the life course, requiring provision of benefits to the affected citizens of a country. Governments should ensure the following provisions: sickness benefits, unemployment benefits, old-age benefits, employment injury benefits, family/child benefits, maternity benefits, invalidity/disability benefits and survivors' benefits. Subsequently, ILO Social Protection Floors Recommendation 202 (2012) further affirmed the human right to economic and social security, and provided a normative standard for pursuing an inclusive approach to SPF provisioning by specifying the minimum coverage needed for all <u>at the floor level</u> over the life cycle:

(a) Access to essential health care, including maternity care;

(b) Basic income security for children, providing access to nutrition, education, care and any other necessary goods and services;

(c) Basic income security for persons in active age who are unable to earn sufficient income, in particular in cases of sickness, unemployment, maternity and disability; and

(d) Basic income security for older persons.

[1] World Bank press release, October 4, 2015.
[2] A/RES/70/1, Declaration paras 3 and 4 and SDGs 1 and 10.

Identifying the means of implementation is the next logical step. A mandate is given in para 12 of the Addis Ababa Action Agenda (AAAA)[3] in which Governments commit to a “social compact”, pledging to deliver social protection to their citizens, including social protection floors. They further pledge to provide strong international support for these efforts, exploring “coherent funding modalities to mobilize additional resources, building on country-led experiences”. Member States have also agreed that initial progress on SDG 1, which includes a target on social protection floors, should be subject to in-depth review in 2017. This provides a good reason for discussion at this time, of options for funding social protection floors.

This discussion paper thus offers a policy context and conceptual framework for an exploratory discussion on financing social protection floors. It reviews a number of salient country experiences in SPF provisioning, highlighting examples of good practice and lessons learned as regards the design and funding of SPFs. It identifies gaps that need to be addressed and challenges that must be faced. It explores the role of international cooperation in supporting national governments as they address the challenges and seek to build and strengthen their SPFs. It reviews, in particular, how that role can be enhanced and deepened, in fulfilment of the mandate given in AAAA para 12. An annex distils some important principles that should guide discussions on strategies for the mobilization of domestic and international public finance for social protection floors.

SOCIAL PROTECTION FLOOR PROGRAMMING - SOME PROMISING RESULTS

Social protection has been an important component of the anti-poverty strategies undertaken by many middle- and low-income countries over the past decade. Some positive results of these initiatives have been noted.

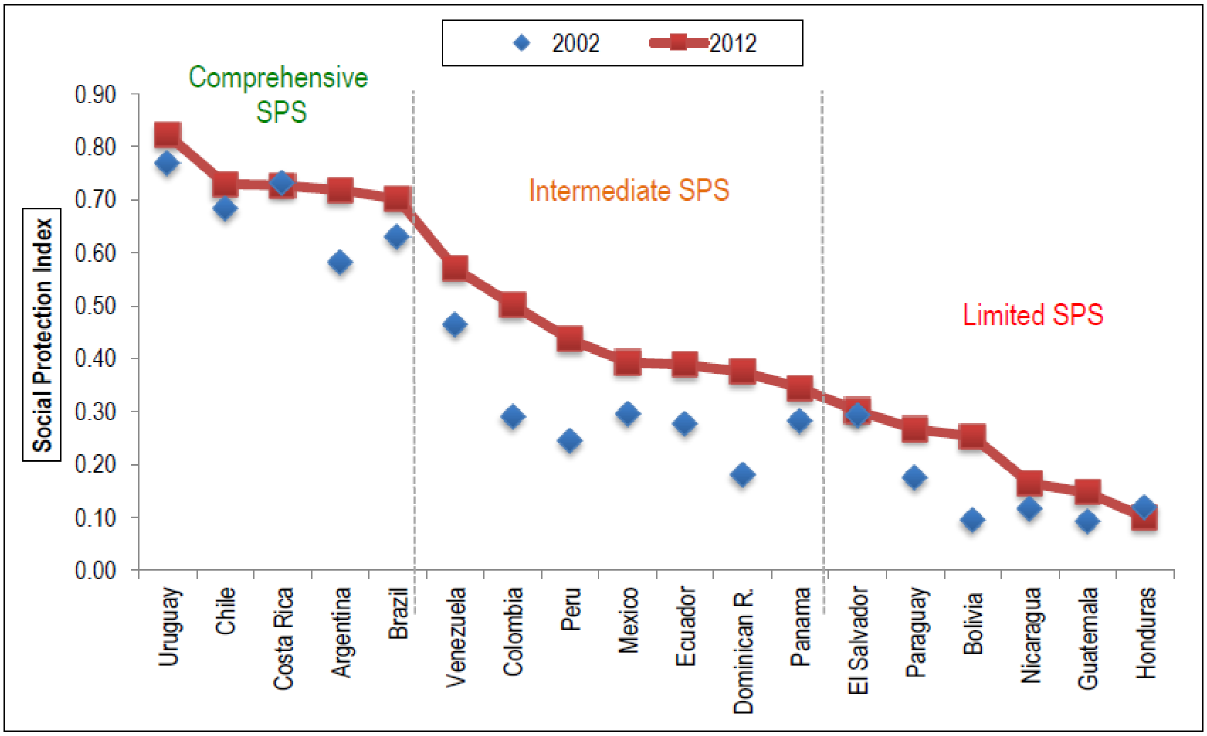
One study revealed that higher levels of social spending were associated with greater improvements in poverty reduction and reductions in inequality in Latin America.[4] The study used a social protection index (SPI) which measures the level of comprehensiveness of coverage for health and pensions, as well as coverage for targeted social assistance. Countries were grouped into 3 categories:

1. Those having low SPI scores, indicating low achievement in social spending and coverage: Bolivia, Paraguay, El Salvador, Honduras, Guatemala, Nicaragua;
2. Those having intermediate SPI scores: Panama, Dominican Republic, Ecuador, Mexico, Peru, Colombia, Venezuela;
3. Those having high SPI scores: Argentina, Chile, Costa Rica, Uruguay, Brazil.

Fifteen out of the eighteen countries studied showed significant changes in their SPI scores over the period 2002 to 2012, reflecting progressive improvements in coverage (figure 1). The countries that made special efforts to reach out to the lowest quintiles and to workers in the informal economy made bigger improvements in the SPI.

[3] Adopted by the UN General Assembly as resolution 69/313.
[4] J.A. Ocampo and N. Gómez-Arteaga (2016), *Social Protection Systems in Latin America,* ILO ESS Working Paper No. 52.

Figure 1. Social Protection Index Score, circa 2002 and 2012



Source: Authors using data from ECLAC (2014a and 2014b), Santos et al. (2015) and WB Data. The figures for 2012 vary from 2010 to 2013.
Note: SP Index is the arithmetic mean of the normalized achievements of each country in all 9 indicators.

Source: J.A. Ocampo and N. Gómez-Arteaga, (2016), *Social Protection Systems in Latin America*, ILO ESS Working Paper No. 52.

A number of lessons can be learned about the mechanisms and approaches adopted by the countries under discussion:

> Colombia moved to a universal health care system, through a scheme combining contributory and non-contributory components.
>
> Bolivia's improved SPI reflects its achievement of near universal pension benefits through a non-contributory scheme, and increased access to pensions by retired workers in the formal economy through a contributory scheme. The non-contributory component covers 95.5% of the target population of older persons. Good results have been registered. Bolivia's poverty rate fell from 59% to 39% between 2005 and 2014.
>
> Peru has made significant improvements in health coverage and access to pensions.
>
> Argentina instituted a universal basic pension.[5]

Results from studies carried out in the Asia-Pacific region also attest to the importance of social protection provisioning for reductions in poverty and inequality. One study has shown a clear

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[5] Ibid.

negative association between the level of inequality (measured by the Gini coefficient) and government social expenditure (measured as a percentage of total government outlays), for a selection of global and Asia-Pacific economies.[6] That is, higher levels of inequality are associated with lower levels of social expenditure. However, many countries of the region have been exploring means to expand their fiscal space and their investments in SPF programming.

DESIGNING AND FUNDING SOCIAL PROTECTION FLOORS - SOME TRENDS

Some current trends with regard to contingencies covered as well as the design and financing of social protection systems and the legislative environment will be reviewed here, as they can usefully inform the discussion on funding modalities for SPFs.

Contingencies covered

A review of contingencies covered by social protection schemes reveals that there are differing country priorities.

A number of countries have prioritized pension benefits to retired workers out of social security contributory schemes, while at the same time attempting to cover informal economy workers as well as vulnerable populations from tax-financed revenues. Countries that have expanded their pension schemes, aspiring to universal coverage include: Bolivia and Argentina (as previously mentioned), Timor Leste, South Africa, Suriname, Thailand, Viet Nam, Botswana, Lesotho, and Namibia.[7]

Some countries have focused on income security through cash transfers targeted to households experiencing poverty, often with an emphasis on alleviating child poverty through child allowances and educational grants, including Timor Leste, Bolivia, Brazil, Mexico, Argentina, Costa Rica, Colombia, South Africa, Uruguay, China, Indonesia, Singapore, Malaysia, Philippines, Mongolia, Nepal, Jamaica.[8] Cash transfers to improve income security in households have been used in Indonesia and the Philippines, while Singapore and Malaysia have used cash transfers as family and child support allowances and for educational grants. Singapore also provides cash assistance to the elderly and the disabled.[9]

Many countries have pursued the goal of broad coverage of essential services, particularly health, including Colombia and Peru (as previously mentioned), Rwanda, Ghana, Viet Nam, Thailand, Philippines, Indonesia. Health has been a priority for Viet Nam which set an explicit goal of covering the entire population, funding health insurance premiums for those in need. Thailand introduced a universal health care scheme in 2002 and old age pensions for the informal sector in 2011. Philippines increased coverage of its Government-run health care system from 62% of the population in 2010 to 85 % in 2012. Indonesia legislated universal

[6] ESCAP (2013), Economic and Social Survey of Asia and the Pacific - *Forward-Looking Macroeconomic Policies for Inclusive and Sustainable Development*, Bangkok., p54, figure 1.23.
[7] Presentation by Isabel Ortiz, Director, Social Protection Department, ILO, at a side event held during the Financing for Development Follow-up Forum, United Nations, New York, 19 April, 2016.
[8] Ibid.
[9] ESCAP 2013, op cit.

health insurance in 2015.[10] South Africa and Brazil have extended maternity protection to domestic workers.

Design and funding

A few countries have emphasized the strengthening of contributory schemes for social insurance, based on employer and worker contributions, prioritizing various contingencies, and have also attempted to reach underserved populations in the informal economy (Uruguay, Argentina). Others have focused on tax-financed systems to provide income security through cash transfers, and for the provision of services such as health and education.

Some countries have sought to combine contributory and non-contributory schemes, exploring the complementarities between these approaches (Brazil, Chile, South Africa, Singapore, Malaysia). Some countries have earmarked revenues from taxes on natural-resource extraction to fund their social protection floors (Bolivia, Mongolia, Timor Leste, Botswana, Zambia). Ghana, Liberia and Maldives use taxes from the tourism sector to fund their social protection programmes. Many countries have relied on indirect taxes, primarily consumption taxes such as value added tax (VAT), to fund their social protection floors, e.g., Brazil and Lao People's Democratic Republic.

A number of innovative mechanisms have also come on stream. Noteworthy among these is Uruguay's monotax. That is, Uruguay has unified various contributory social security schemes and tax-based programmes into a single system. This innovative solution served to overcome the segmentation in benefit schemes between salaried workers in the formal economy, and non-salaried, self-employed workers in the informal economy. It is basically a system of cross-subsidization, based on the principles of solidarity, inclusiveness and equity. It is progressive both on the supply and the demand side in that contributions are made on the basis of people's ability to pay, and benefits are disbursed following equitable, needs-based criteria.[11]

Argentina has instituted a similar system of cross-subsidization of contributions, allowing coverage for the self-employed and for workers in small and medium enterprises (SMEs) that are typically excluded from contributory schemes, and that lack social protection. Brazil has also simplified its income tax structure to allow for contributions from and extension of benefits to SMEs.[12] These approaches also help reduce the informalization of the labour market and smooth out the inequality produced by the segmentation of benefits, which disadvantage workers in the informal economy. Tunisia has also expanded social security coverage, granting access to workers in the informal economy.

Bolivia expanded its fiscal space and prioritized expenditures on social assistance programmes by making changes in the tax regime and ownership structure in the oil and gas sectors, and applying the revenues generated. Bolivia's shift from an 82% producer share of hydrocarbon revenues (18% to the Government) to a 50-50 split, resulted in large increases in public revenues

[10] Ibid.
[11] Ocampo and Gómez-Arteaga, op.cit.
[12] Ibid.

as from 2005. With the nationalization of the gas sector in 2006, the state share of royalties rose to 80%.[13]

Similarly, countries of the Asia Pacific region have been exploring various pathways to expand fiscal space while prioritizing social expenditure. Viet Nam has focused on developing the tourism industry. Timor Leste uses oil revenues to fund its social protection programmes. Mongolia uses royalties from its resource extraction sector to fund social protection programmes. The Lao People's Democratic Republic relies heavily on indirect consumption taxes to fund its SPF programmes (notwithstanding the inherently regressive nature of this mechanism), and has established a state accumulation fund for use in the event of economic shocks or ecological disasters. Thailand and Myanmar have decreased their military spending, thus freeing up resources for SPF provisioning.[14]

Enabling legislative environment - the case of South Africa

The constitution and laws of South Africa provide social protection guarantees as a human right. This has important implications for the political priority in implementing the state's obligations, including financial obligations for social protection provisioning. The resulting system aims to provide comprehensive coverage, with complementary contributory and non-contributory financing components.[15] Various tax-financed systems provide protection through cash transfers to cover child support, care dependency support, assistance to persons with disabilities and older persons. Contributory schemes of social insurance provide unemployment, maternity and sickness benefits. Informal economy workers are not covered by these contributory schemes. Nevertheless, the system has made significant contributions to poverty reduction, decreasing the incidence of poverty among older persons from 55.6% to 36.2% between 2006 and 2011. The Child Support Grant covers 11million out of a total target population of 19million children. It has, reportedly, contributed significantly to reductions in child poverty in South Africa.

However, there are gaps in South Africa's social protection system. Contingent risks associated with the active age population are covered by social insurance, and informal economy workers are not covered. In addition, tax administration needs to be strengthened. Ultimately, however, the reduction in South Africa’s poverty and the sustainability of its social protection programmes depend on adequate expansion of the economy (hence on tax and contributory revenues) and on decent jobs, (for reducing demand on the social system).

GAPS, CHALLENGES AND THE WAY FORWARD

Despite a decade and a half of anti-poverty programmes undertaken in many middle- and low-income countries, including SPF programmes, inequality, vulnerability and poverty are still very persistent in many populations. High levels of labour market informality, low productivity and precarious wages keep many people in poverty. While SPF programmes are striving to provide minimum income security, primarily through cash transfers and pensions, benefits are generally low, and the reach to populations in need is limited. Huge gaps are evident by type of

[13] Social Protection in Action-ILO Policy Brief 2016-Bolivia
[14] ESCAP 2013, op cit; Presentation by Isabel Ortiz, op cit.
[15] Social Protection in Action-ILO Policy Brief 2016-South Africa

employment, with workers in the formal economy benefiting from coverage through social insurance schemes, while workers in the informal economy typically lack social protection.

For example, in the study on Latin America mentioned earlier, only 49.2% of the employed population in countries registering low SPI scores were formal economy salaried workers. The corresponding figure was 55.9% for countries in the intermediate range of SPI scores. For the group of countries with the highest SPI scores and thus greatest social protection coverage, 72.8% of workers were employed in the formal economy, a majority benefitting from contributory social insurance.[16]

Informal employment in vulnerable jobs with limited access to social protection is quite pervasive in the Asia-Pacific region. About 80% of non-agricultural workers in India, Nepal and Pakistan are engaged in the informal economy. For the Philippines, Viet Nam and Indonesia, the corresponding share of informal employment among non-agricultural workers is 70%.[17]

Similarly, gaps are evident by level of income, with low-income workers receiving very little coverage as compared to high-income workers.

Gaps exist in pension coverage from non-contributory schemes, which are generally weak in many middle- and low-income countries. For example, Ecuador's scheme covered only 30.3 % of the target population (urban area), and Mexico's scheme covered 33.6% of the target population in 2015.[18]

Gaps exist by type of contingency also, with some contingencies poorly covered, in particular maternity and disability, as well as basic income security for children.

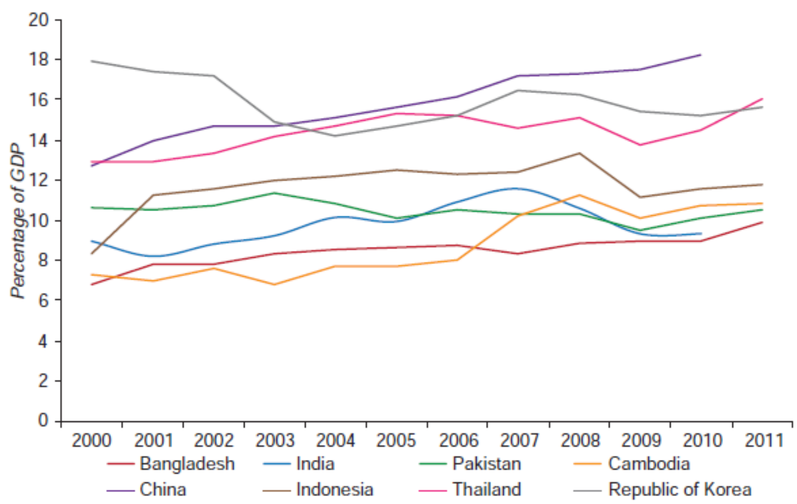
Expand fiscal space

Governments need to expand their outlays for social protection if they are to fill the gaps and raise the overall level of support, which in most cases is extremely modest. This challenge is often referred to as expanding "fiscal space" for social protection, meaning freeing up public resources used elsewhere and/or increasing the amount of available resources to use for SPFs.[19] The annex to this paper argues that social protection floor programmes should be treated as priority entitlements for public funding, and that discretionary outlays for other public goods and services should benefit from expansion of fiscal space. By the same token, when boom turns to bust or crises of various sorts occur, the capacity of government to maintain spending declines; i.e., fiscal space contracts. In either case, however, the challenge that public authorities face may be phrased as managing and expanding overall fiscal space.

[16] Ocampo and Gómez-Arteaga, op.cit.
[17] ESCAP 2013, op cit.
[18] Ocampo and Gómez-Arteaga, op. cit.
[19] A comprehensive exposition of the concept as applied to expanding social services in developing countries is provided in Isabel Ortiz, Jingqing Chai and Matthew Cummins (2012), "Identifying fiscal space: Options for socio-economic investments in children and poor households," in *A Recovery for All*, Isabel Ortiz and Matthew Cummins (eds.), UNICEF, New York, pp. 231-301.

In many countries, government administrative procedures and infrastructure need to be strengthened, including through the more effective use of information technology. This applies on the revenue side, where tax administration is often weak, as well as on the expenditure side of the budget. Opportunities often exist to improve the efficiency of tax collection per se as well as to improve the elasticity of taxation, wherein revenues would rise more than in proportion to increases in income. For the Asia-Pacific region, this is evident from the fact that the ratios of taxes to gross domestic product (GDP) have remained fairly constant in much of the region despite strong economic growth, with ratios ranging typically between 10% and 16% for the period 2000 to 2011 (figure 2). These data reflect the lack of progressivity of tax structures, with negative consequences for the mobilization of revenues for public expenditure.[20]

Figure 2: Tax-to-GDP ratio in selected developing Asia-Pacific economies



Source: ESCAP, based on data from CEIC Data Company Limited. Available from http://ceicdata.com (accessed on 8 February 2013).

Source: ESCAP (2013), Economic and Social Survey of Asia and the Pacific - *Forward-Looking Macroeconomic Policies for Inclusive and Sustainable Development*, Bangkok.

Many governments also need to broaden and diversify their tax base, and improve the progressivity of taxation for reasons of fairness and perceptions of fairness, as well as to increase public revenues. In this regard, valuable lessons can be learned from some of the country experiences mentioned above. The case of Bolivia discussed earlier shows that a revision of ownership structures of natural resource extraction and progressive taxation in the extractive sectors can considerably expand fiscal space. Innovative mechanisms that have worked successfully can be further explored, for example, mechanisms for combining social insurance from individual contributions with social assistance, financed from tax revenue, as in Uruguay and Argentina.

It must be appreciated, moreover, that public finance is a political and not just a technical challenge. The experience of Brazil demonstrates the complex politics of earmarked resource mobilization. Brazil adopted a financial transaction tax (FTT) on all transactions of individuals and businesses with banks, initially to help improve the nation’s public health system, later to

[20] ESCAP 2013, op cit.

help fund the *Bolsa Familia* and other programmes.[21] It turned out that tax collections rose appreciably following adoption of the FTT, only in part owing to the FTT per se, as the information on bank transactions collected by the central bank was shared with the tax authorities, which discouraged tax evasion.[22] One may assume that the anti-poverty use of FTT funds was one reason the public and the legislature approved the tax. On the other hand, it may be assumed that people with money to hide and the financial industry per se opposed the tax. Maintaining the tax required the continued buy-in of the national legislature and stake-holders. Despite the success of Brazil's FTT, the political environment was not conducive to sustaining it, and it was discontinued.

To ensure the legitimacy of tax reforms, national dialogue and consensus-building are important, as is cultivating the concept of solidarity across populations, indeed, the establishment of national social compacts. Uruguay's monotax reflects this concept of solidarity, and an understanding that a segmented system with widely different coverage for the formal and the informal economy is inimical to achieving significant reductions in inequality, and undermines social cohesion.

Many countries are undertaking national tri-partite dialogues on SPFs, with technical assistance from the ILO. These dialogues, involving governments, trade unions, employers and civil society organizations, aim to develop national consensus on priorities and strategies for building social protection systems and floors. In addition, ILO has published a global guide for undertaking assessment-based national multi-stakeholder dialogues on social protection floors, drawn from experiences with pilot exercises in 14 countries.[23] As of April 2016, dialogues had been completed or were on-going in 18 countries, while they were being planned in another 11 countries.[24]

Institutional arrangements matter. In addition to strong tax authorities and efficient tax collection systems, the institution of transparency initiatives and monitoring mechanisms to ensure equity and compliance with agreed rules and standards are key to sustained financing of SPFs. Again, the example of Bolivia is instructive. Bolivia instituted a transparency initiative which helped ensure efficiency, equity and good governance in the management of public revenues. Civil society organizations monitor companies' compliance with their tax obligations and transfers to the State as well as the management of public expenditure. A system of transparent reporting of transactions and transfers is in place.

The way forward

From the foregoing discussion it is clear that there is no "one-size-fits all approach" to designing and funding SPFs. The choice to fund social protection out of social insurance or non-contributory schemes, or from a mix of both, will be determined by a range of factors, and not least, the structure of the labour market, and the relative share of workers in formal and informal

[21] Social Protection in Action-ILO Policy Brief 2016 - Brazil.
[22] Isaias Coelho (2009), "Taxing bank transactions – the experience of Latin America and elsewhere," Paper prepared for the third International Tax Dialogue Global Conference, Beijing, October.
[23] ILO (2015), *Social Protection Assessment-based National Dialogue: A Global Guide*, Geneva.
[24] Presentation by Isabel Ortiz, 19 April, 2016, op cit.

employment. Countries with a sizeable formal economy and satisfactory social security coverage can prioritize the strengthening of social insurance. Countries with a sizeable informal economy must necessarily prioritize tax-financed, non-contributory schemes to cover contingent risks and income security for the populations concerned. All countries must determine the appropriate mix of contributory and non-contributory regimes.

To expand the non-contributory component of social protection systems, Armando Barrientos counsels an approach of gradually increasing social protection expenditure as a percentage of GDP. Countries whose social protection outlays are less than 1% of GDP should consider setting the target of reaching 1% of GDP. Countries whose social protection outlays are less than 2% of GDP should consider setting the target of reaching 2%, etc.[25] Expanding fiscal space through improving the progressivity of taxation and prioritizing public social expenditure is key to strengthening income security and public service delivery, and thus to realizing universal social protection.

THE ROLE OF INTERNATIONAL COOPERATION

The foregoing discussion on country experiences with designing and funding SPFs highlights a number of gaps and challenges, and suggests the means countries might pursue to address them. It also follows from the discussion that there are important areas that should be considered for international cooperation. The basic vision that should underlie consideration of the subject is that social protection and its financing are a domestic government responsibility. Governments must own and take responsibility for building their SPFs, including the recurrent costs of funding benefits. The goal of universal coverage implies the setting of targets to progressively cover all the people who will not be able to afford to participate in contributory systems.

The implication is that there are different potential areas for international cooperation. One of them is uncontroversial and another is highly controversial, while a third is somewhat in between, as it has yet to be tried.

Traditional approaches to technical cooperation and risk mitigation

Offering international assistance to help countries establish or improve their SPFs is not only uncontroversial, it is also being provided by a number of donor governments and international institutions. Indeed, at the request of the Group of 20, ILO and the World Bank convened a new coordination mechanism in 2011 at the United Nations, the Social Protection Inter-Agency Cooperation Board (SPIAC-B). It brings together relevant global, regional and bilateral development institutions that work at country level on social protection advocacy, financing and/or technical advice, and includes as observers major civil society organizations working in the field.[26]

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[25] Armando Barrientos (2016), presentation to webinar on "Fiscal space for social protection: social compacts for sustainable financing of social protection systems," organized by UNDP and HelpAge International, Washington, D.C., 28 October (http://socialprotection.org/discover/publications/webinar-presentation-fiscal-space-social-protection-social-compacts).

[26] "Social Protection Interagency Board: Terms of Reference," (http://www.ilo.org/wcmsp5/groups/public/---dgreports/---nylo/documents/meetingdocument/wcms_211033.pdf).

The currently envisaged scope of donor grant financing such as official development assistance (ODA) could cover one-off costs. We have seen that weak administrative structures is a common problem faced by many developing countries in establishing and strengthening their SPFs, in setting up their collection and disbursement systems, including outreach to rural and remote regions. Technical and financial support for institutional and human capacity building may also be considered for external short-term financing to boost domestic, longer-term sustainable planning timeframes for SPF programming. Providing research support to assist countries in establishing the evidence base to underpin the design of their SPFs can be another area for one-off grant funding, as is external assistance for automating administrative systems for service delivery management. Direct budget support may be considered an optimum delivery mechanism for such ODA allocations for SPFs.

There is yet another traditional area of international financial cooperation that should be considered. Our global financial and economic system is highly volatile, and the need for social protection rises and falls with the predictable regularity of economic cycles of boom and bust, as well as with unpredictable and usually unforeseen natural and economic shocks, including earthquakes and global financial crises. Countries subject to economic volatility are wise to build up fiscal surpluses during boom times to draw down during times of bust. There is a trade off, of course, between the size of the accumulated fiscal trust fund and the opportunities for current expenditure foregone to add to that trust fund. Most countries will try to cover their most likely needs through their own resources. Those with special endowments, as of highly-prized natural resources, will be able to cover more of their fiscal risks than other countries. To supplement the protection that countries can provide from their own resources, the international community offers loans on a variety of terms and conditions, principally through the International Monetary Fund, but also through the international development banks, as well as bilateral cooperation in various situations. These loan funds are not earmarked for SPFs but are supplementary budgetary resources that can be allocated to SPFs as well as to meet other public needs. This is a traditional and thus also uncontroversial form of international cooperation.

Recently, an additional approach has been under consideration in a variety of official and academic circles. That is, it is most common for governments to treat their debt-servicing obligations to their creditors as the first call on the use of official revenues. Debt servicing, whether owed to official or private lenders, comprises interest and principal payments that must be paid according to a specific schedule detailed in the contract signed by the borrowing government. This unremitting obligation can cause serious difficulties in public finance during periods of stress, owing to economic or natural causes. The question could be asked, therefore, if those unforeseen risks should not, to some degree, be shared between the creditor and the debtor.

While not standard in Western lending, the concept of risk sharing between borrower and lender has long been standard in Islamic finance, where the lender may be roughly said to take an equity-like stake in the outcome of the loan. Some governments, such as those of Indonesia and Malaysia, have issued several such *sukuk* instruments in US dollars and local currency, and they have been heavily oversubscribed, meaning that this instrument found a huge demand. In 2014, the British Government launched a *sukuk* instrument of its own on the London financial market, raising £2.3 billion, indicating that significant demand for such instruments might exist outside the Islamic world.[27] Indeed, other *sukuk* sovereign issues have been launched on the Hong Kong, Luxembourg and South African financial markets. This is clearly an area of financial innovation, as these financial instruments are being issued in markets governed by different legal, regulatory and taxation frameworks.

Proposed risk-mitigation innovations

The standard financial contract that fixes debt servicing obligations for the duration of the loan usually means the only opportunity to change the terms of repayment is in the presence (or threat) of non-payment owing to circumstances beyond the control of the borrower, i.e., a debt crisis. Questioning whether this has to be the case, considerable financial and legal work has been done, centred on the Bank of England and the Bank of Canada, on designing sovereign bond contracts for sale to the private sector that would require creditors to share risk of difficult times with their sovereign borrowers without going through a literal restructuring exercise. One approach has been called "sovereign cocos", which would build on an instrument that is already an option that banks and corporate borrowers can offer their lenders, called a "contingent convertible" (coco). In those bonds, some pre-specified event triggers the conversion of the bond into some form of equity security that has lower priority for repayment and no longer obligates the borrower to pay interest. As private investors cannot own governments, the "sovereign coco" would maintain a bond's structure but delay principal repayments according to a prearranged schedule. It could also specify triggers for further delay. (A quid-pro-quo in some presentations is that the country should also receive a loan from the IMF, putting it under the usual IMF conditionality).

A different proposed innovation is a GDP-linked bond, wherein the borrower agrees to pay the lender a base interest rate plus an addition (or minus a subtraction) according to the performance of the borrower's economy. Until now, bond payments linked to gross domestic product have only been issued as part of sovereign debt workouts, notably by Argentina. Interest payments were earlier linked to the price of a major export, usually oil, as in the debt restructurings of Mexico and Venezuela at the end of the 1980s. No GDP-linked bonds have been sold to financial investors under normal market conditions, but like sovereign cocos, it is believed they could find a market.[28]

For the most part, these innovations would serve as a way to "bail in" private creditors during a sovereign country's period of financial distress, although the French aid agency (Agence Française de Développement) developed a *prêt contracyclique* for its own loans extended to a number of African countries.[29] The French loan takes the latter five years of its standard ten-year grace period and allows the borrower to use it at any time, including postponing its final maturity date by five years. This option, like the sovereign coco, is a contemporary form of the "bisque" clause in sovereign debt contracts, whose use can be traced back at least to United States loans to

[27] "Government issues first Islamic bond" (2014), HM Treasury, press release, 25 June (https://www.gov.uk/government/news/government-issues-first-islamic-bond).
[28] Martin Brooke, Rhys Mendes, Alex Pienkowski and Eric Santor (2013), "Sovereign Debt and State-Contingent Debt" Bank of Canada Discussion Paper 2013-3, November [simultaneously issued by Bank of England].
[29] For a recent assessment, see Commonwealth Secretariat (2016), "Extending Countercyclical Loans: Lessons from Agence Française de Développement."

the United Kingdom in 1946, which gave the UK options to postpone repayments under specified conditions. Following the overthrow of President Sukarno, a bisque clause was included in Indonesia's debt restructuring, and it has been proposed to make such a clause a standard part of Paris Club restructurings of debt owed to sovereign creditors.[30]

International funding for at-risk countries

Most countries have the means, and can find the fiscal space to strengthen their SPF provisioning with the aim of reaching universal coverage at least during normal circumstances. However, a small number of highly stressed developing countries may require some more sustained funding on ODA terms. This is the conclusion emerging from a study undertaken by a team of scholars at the Maastricht Graduate School of Governance.[31]

The team produced a Social Protection Floor Index (SPFI) which uses estimates of a population's income security and health coverage to rank middle and low-income countries on their shortfalls in meeting SPF provisioning, measured against standards derived from the definitions in ILO Recommendation 202. While the composition and extent of each country's actual social protection floor should be decided through national dialogue, the index was meant to provide a rough benchmark from which to compare countries' SPF financing capacities and needs.

According to the SPFI, many middle income countries have index values of zero or close to zero, indicating no gaps or only small gaps in their funding requirements, which they could meet themselves through budget re-allocations or other means without having recourse to external financing. Countries with wider gaps are deemed to possibly require some support to help them strengthen the human capacity and administrative structures of their SPF systems. Countries at the bottom of the ranking where the resources needed are estimated to exceed a benchmark that would need to be selected, say 5% of gross domestic product, would likely require grant financing, such as from official development assistance, for meeting recurrent costs over the medium term, in addition to start-up costs.

Thus far, no country has stepped forward to provide dedicated financing for SPFs in those countries most in need according to the Maastricht analysis. Perhaps one deterrent is uncertainty as to how long such assistance would be required. The international community does provide financial resources to countries in extreme distress owing to natural calamities or to support peace-building efforts as in post-conflict situations. However, support for these recovery efforts is explicitly limited in duration, and relies on voluntary international contributions (often in less than targeted amounts). This means the usual modality for international emergency assistance would not be adequate for SPF financing. It is also, finally, not necessary.

Budget resources are fungible and all countries should be able to mobilize enough revenue domestically to cover their most essential expenditures, defined in this case to begin with the

[30] Enrique Cosío-Pascal (2010), "Paris Club: Intergovernmental Relations in Debt Restructuring," in Barry Herman, José Antonio Ocampo and Shari Spiegel (eds.), *Overcoming Developing Country Debt Crises* (Oxford).
[31] Mira Bierbaum, Annalena Oppel, Sander Tromp and Michael Cichon (2016), "Social Protection Floor Index - Monitoring National Social Protection Policy Implementation." Discussion Paper, Friedrich Ebert Stiftung, April (http://library.fes.de/pdf-files/iez/12490.pdf).

SPF, keeping in mind that the SPF is a floor and not the sum of socially warranted expenditures nor obligations above the floor level as for civil service pensions. In such circumstances, even the poorest countries should be able to cover their SPF, while fully warranted international assistance should be deployed to help cover the discretionary parts of the government's budget that are essential for sustainable development, including outlays to help the country strengthen or establish its SPF system. Deploying ODA to help finance discretionary government spending (including public investment) is standard practice. The challenge for donors and for cooperation among Southern countries is to provide enough of it to meet the need.

In short, a disinclination of donors to directly fund even the poorest country's SPF would not excuse it from the obligation to assist the country on the basis of commitments to development cooperation and human rights. The annex that follows elaborates on these concepts.

<u>Annex</u>

PRINCIPLES AND MECHANISMS FOR FINANCING SPFs – A PROPOSAL

The overriding concept governing policies on social protection floors should be one of human solidarity, giving force to human rights obligations. At the United Nations, human rights are not just "self-evident" natural law or derived from religious belief or ethical concepts, but legal obligations of Member States. That means that the international community should guarantee that people all over the world would enjoy those human rights wherever they live. As nation states are sovereign, they bear the primary duty to realize those rights in their own territories. This leaves concrete implementation and enforcement of those rights to the separate nation states, albeit subject to inter-state normative discussion to try to reach agreed standards.

Nation states also collaborate so that states in more advantageous situations assist states in less advantageous situations to implement more generous policies than they might otherwise be able to undertake on their own. To some degree, that obligation is met through state-to-state assistance, although in cases where either the donor or partner country faces difficulties—and in some cases as a general principle—the assistance has been provided through non-governmental channels (churches, foundations, secular NGOs). Thus, the primacy of the national obligation of the governments of states to their own people (sometimes constitutional, as in South Africa) and the additional obligation (in the spirit of the AAAA social compact), of high-income countries to assist low-income countries, should combine to offer a measure of social protection to everyone in the world. When we speak of "social protection floors", we speak about states taking responsibility to provide at least a minimum level of that protection to their own people and to assist other states to provide a measure of protection to their people. The objective, most simply stated, is "leave no one behind."

Social protection floors are thus commitments undertaken by governments to guarantee a minimum level of directly provided goods and services or cash transfers with which to purchase those goods and services. This commitment should cover all individuals over their full life cycle, and thus has different specific content for people in different situations and different stages of their lives. Countries can decide to make the minimum level of support higher for the aged or children than for people of working age, but they should seek to cover everyone in each category at the guaranteed minimum level. They should also increase the minimum level of social protection over time, as growth of national income permits. Whatever the package of goods, services and/or cash that is guaranteed under the SPF, the government must be able to mobilize the financial resources to provide that package, regardless of the circumstances. This seems to entail a number of public finance principles:

1. The political system must **accept to fully fund the SPF under virtually any and all circumstances**. That means it must be among the highest priorities for government expenditure. Funding the approved SPF is a mandatory, non-discretionary public spending obligation.

2. **SPFs are specific entitlements guaranteed to named classes of people (e.g., children, aged, disabled, unemployed) that governments must assure are provided**. As the population grows or needs temporarily expand, SPF outlays must expand as required.

3. In countries with democratic governments, the **voting public must own the obligation** to SPFs, as they will be primarily responsible to fund them. This presumes periodic widespread public discussion of the fiscal obligations, periodic review and revision (in particular, upgrading) in legislation and consistent implementation by the authorities.
4. **Governments and the public must counter efforts to abuse the social protection system** or to avoid responsibility for paying for the SPF. Violations must be strenuously resisted, demeaned and prosecuted, as they undermine public support for the programs.
5. While entitlements as a class of government expenditure can be increased or reduced by legislation, **SPF goods and services or cash transfers per capita cannot be reduced**.[a]
6. In order not to violate these principles, governments must engage in **medium-term fiscal planning and budgeting**. In this regard, they must cover entitlements, other obligatory payments (as to creditors) and discretionary current outlays from current public revenues over the span of the plan, reserving long-term borrowing to the investment account.
7. Fiscal planning also includes preparation for a range of contingencies that the country should be able to handle itself, drawing on **countercyclical borrowing as needed during downturns and other contingencies, with repayment from public revenues on recovery**. Timely payments owed to sovereign creditors and vendors should be subsidiary to staying current on SPF obligations and government employee wages.
8. In this spirit, a substantial **portion of sovereign borrowing instruments should embody contingent repayment clauses** to reduce fiscal pressure during difficult times (e.g., sovereign "cocos", GDP-linked bonds, "bisque" clauses in inter-official loans). Islamic finance (sukuk bonds), which replace interest payments with income sharing, may also contribute to more effective risk sharing in sovereign debt management.[b]
9. For countries with volatile streams of tax revenues, e.g., owing to dependence on taxation or royalties on commodity or mineral exports, **building up fiscal trust funds or similar mechanisms during good times to draw upon during bad times** will help meet SPF obligations, as will adequate accumulation of foreign exchange reserves.
10. The **international community must assist countries experiencing unusual fiscal stresses** beyond those stresses it can handle on its own, owing to international solidarity and concern for global financial stability and economic growth. This entails providing loans on appropriate conditions and terms (including grants as warranted) depending on the severity of the situation. Access to appropriate pre-arranged lines of credit and semi-automatic borrowing facilities should meet the potential need.
11. When a government falls into a sovereign insolvency crisis, the international community must assist the country to **resolve the debt crisis in a fair, transparent and effective**

[a] For example, when governments promise generous pensions without arranging for sufficient contributions to fund them, subsequent legislation may resolve the inconsistency by reducing the pensions and/or increasing taxpayer contributions, but they must not reduce support below the nation's social protection floor for senior citizens.
[b] The alternatives types of sovereign finance mentioned here are described in the text. Note that some sovereign debt instruments need to retain the traditional form in Western financial systems, especially owing to their role as a "risk-free" benchmark for pricing other securities and as the collateral in swaps and other short-term inter-bank lending.

way, including avoiding disruption of its SPF outlays. Further international discussions to boost that capacity are warranted, as per AAAA.

12. The international commitments to the 2030 Agenda and the Addis Agenda on Financing for Development embody an obligation to assist countries in developing their social protection systems, including floors. To this end, **additional official development assistance earmarked for helping to build social protection floors** is warranted. Establishing a multi-donor trust fund could facilitate such a coherent international mobilization effort.

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