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# Fiscal Spending & Social Protection

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Adapted from UN University presentation by Franziska Gassmann



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- Outline
- Financing social protection
- How much does it cost? (...economics...)
- Current spending on social protection
- Is it affordable? (...politics...)
- Creating fiscal space

## Current debate

- Current debate: is a basic SP package affordable in LICs and MICs?
- The introduction or extension of social protection in low- and middle income countries requires substantial funding.
- Governments are faced with financial constraints and fear the commitment to long-term liabilities.
- What about competing national objectives?
- Is financing through taxation a feasible option?
- Costs determined by size of target population, benefit levels (and administrative efficiency)
- Can sufficient fiscal space be found or created for SP?
- How to design and finance programs that promote equitable resource redistribution and economic growth?



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## SP Research & Tools

UN / ILO:

- Affordability studies of social protection in LICs
- Social security expenditure database
- Tools to assess program gaps & calculate costs of SP (HelpAge, CODI, SPF, RAP)

World Bank (similar to UN / ILO)

AfDB: social protection index, expenditure data

IMF: recognition that SP can play a role as automatic stabilizers during crisis

FAO: Infusion of Social Protection principles to agriculture sector intervention

G20: agreement on Social Protection Floor

WEF: Social protection as economic stabilizer both in good and bad times

## How much does it cost?

-Data mainly based on simulations, due to limited evidence base for LICs

ILO / UNICEF, HelpAge Tool,

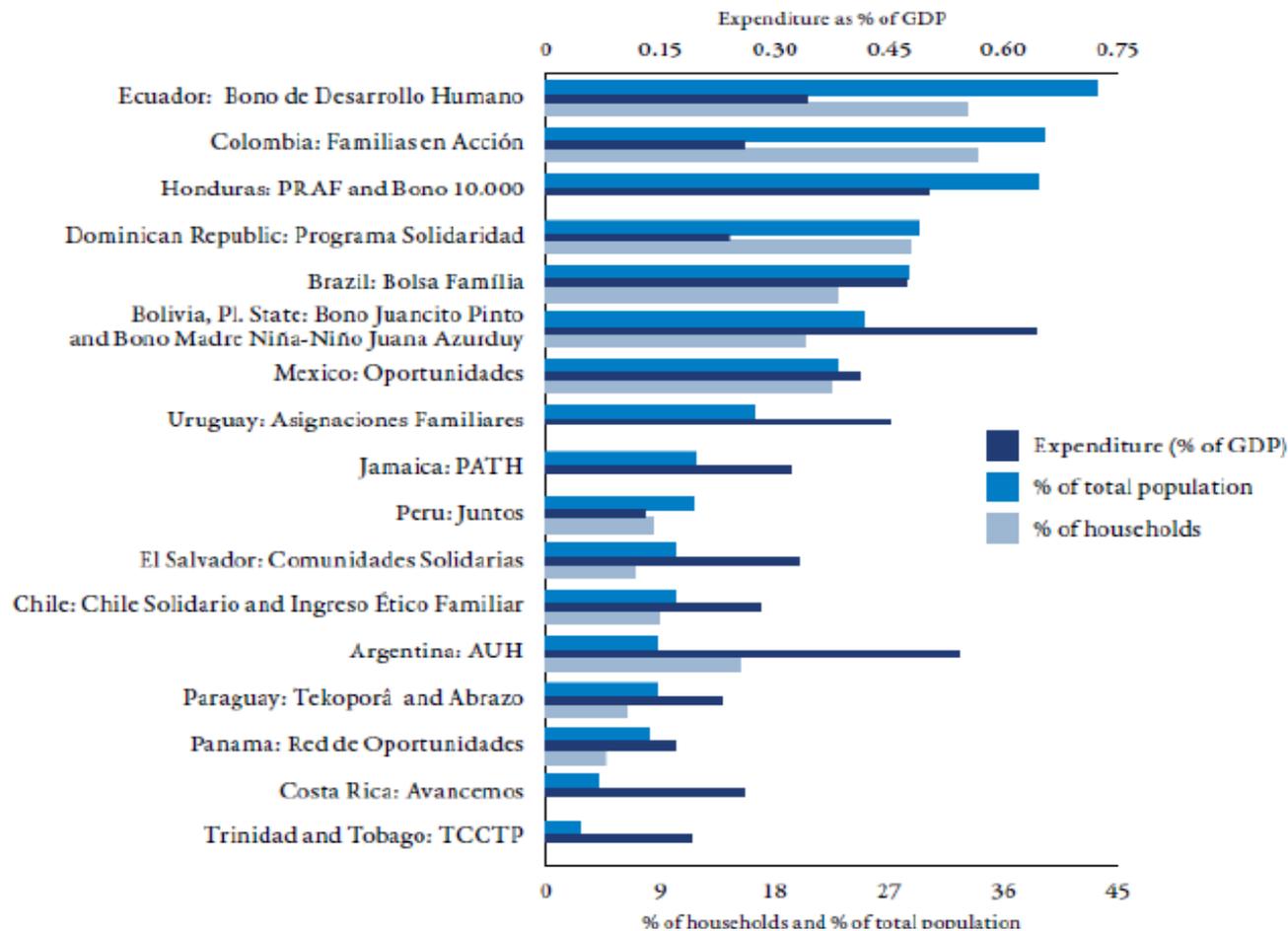
Main focus on cost of non-contributory conditional cash transfers (CCTs):

- Universal pensions
- Child allowances
- Extremely poor households

## Cost of Selected CCTs



Figure 2.7 Level of expenditure and proportion of population reached by non-contributory conditional cash transfer programmes in selected Latin American countries, latest available year (percentages)



Source: ILO 2014

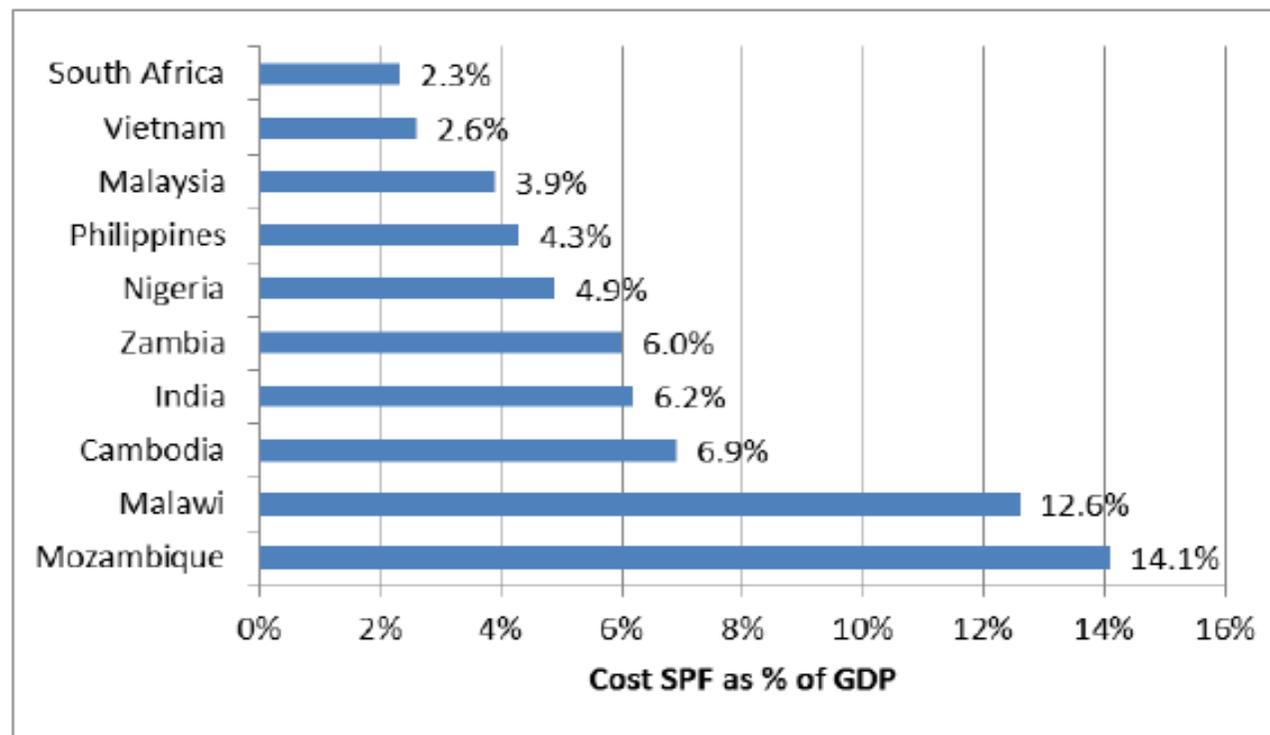
## ILO Costing 2015 (excl. Health)



- Estimated recurrent costs of a SPF on average 2.9% of GDP
- Big differences across regions and countries
- Costs depend on various factors:
  - Demographic composition of population
  - Economic situation/poverty levels
  - Relative wage levels

### Regional averages

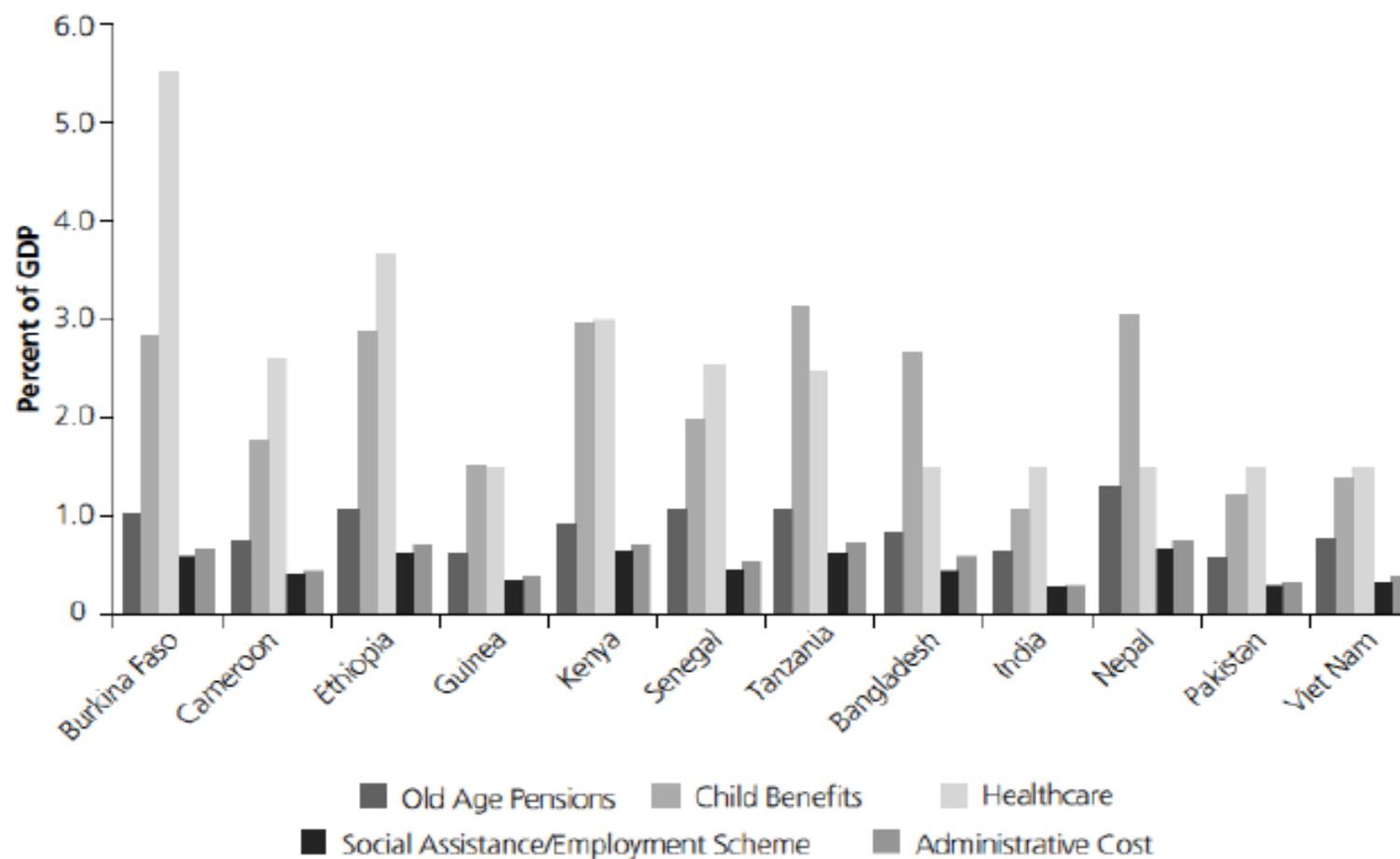
Asia & Pacific	2.6%
Europe & Central Asia	4.8%
Latin America & Caribbean	2.7%
Middle East & North Africa	2.6%
Sub-Saharan Africa	5.5%



## Cost of Selected Components



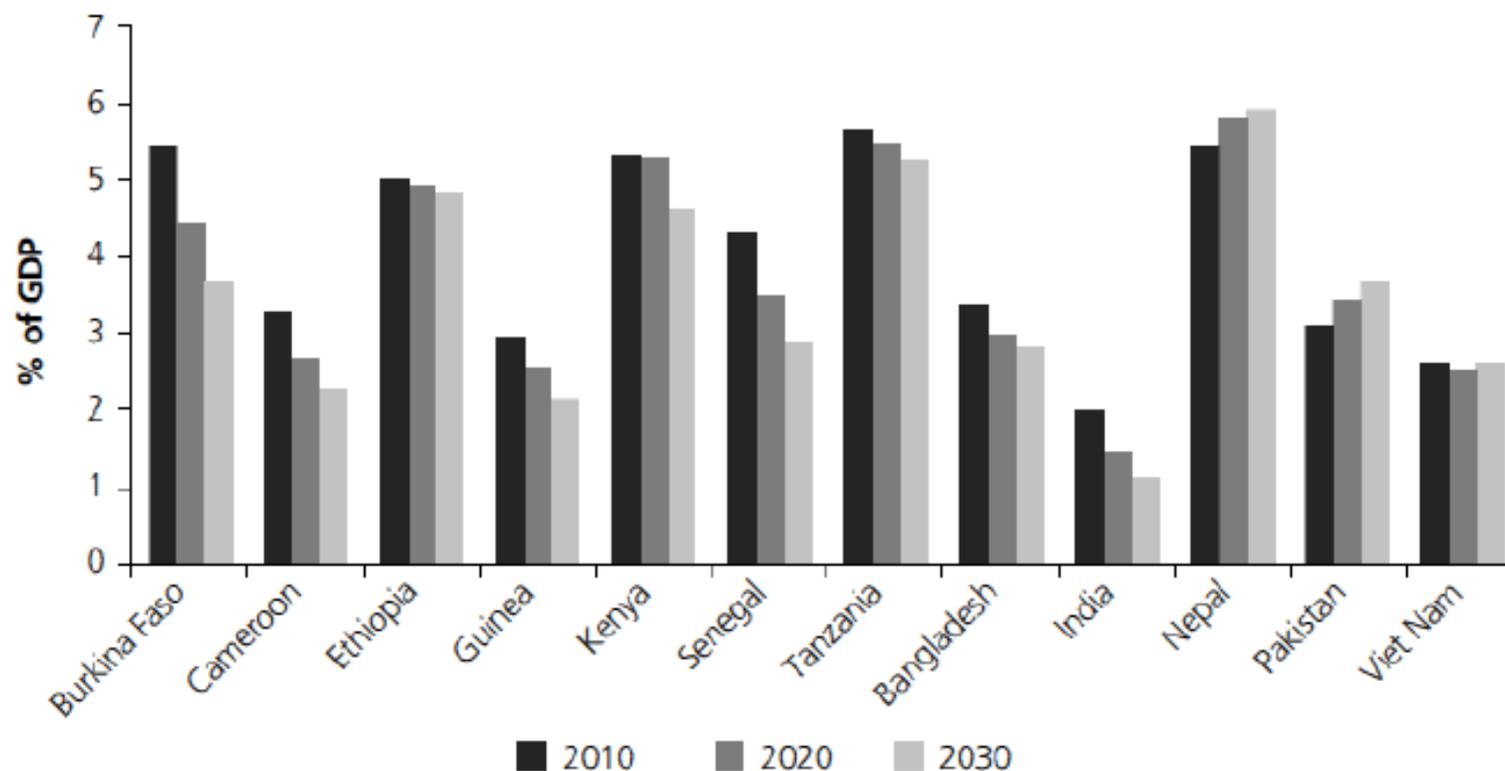
**Figure 6. Costs of Components of a Basic Social Protection Package**  
 (% of GDP, selected countries in Africa and Asia, 2010)



GDP = gross domestic product.  
 Source: ILO (2009a: 29).

## Costs Will Change Over Time

**Figure 7. Estimated Cost of a Package of Basic Transfers**

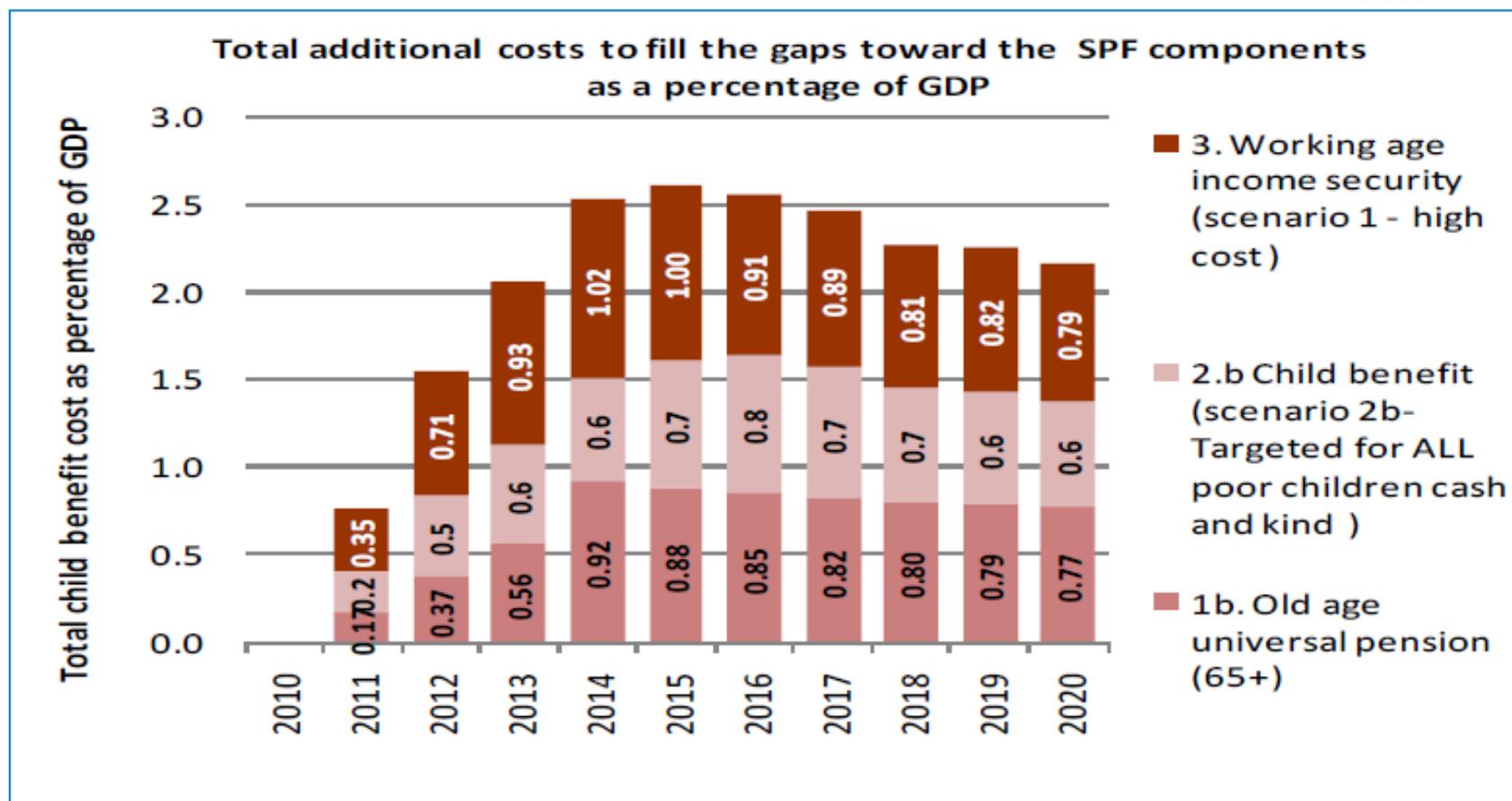


GDP = gross domestic product.

Note: The package includes old age pension, child benefits, a social assistance/employment scheme, and administrative costs.

Source: ILO (2008).

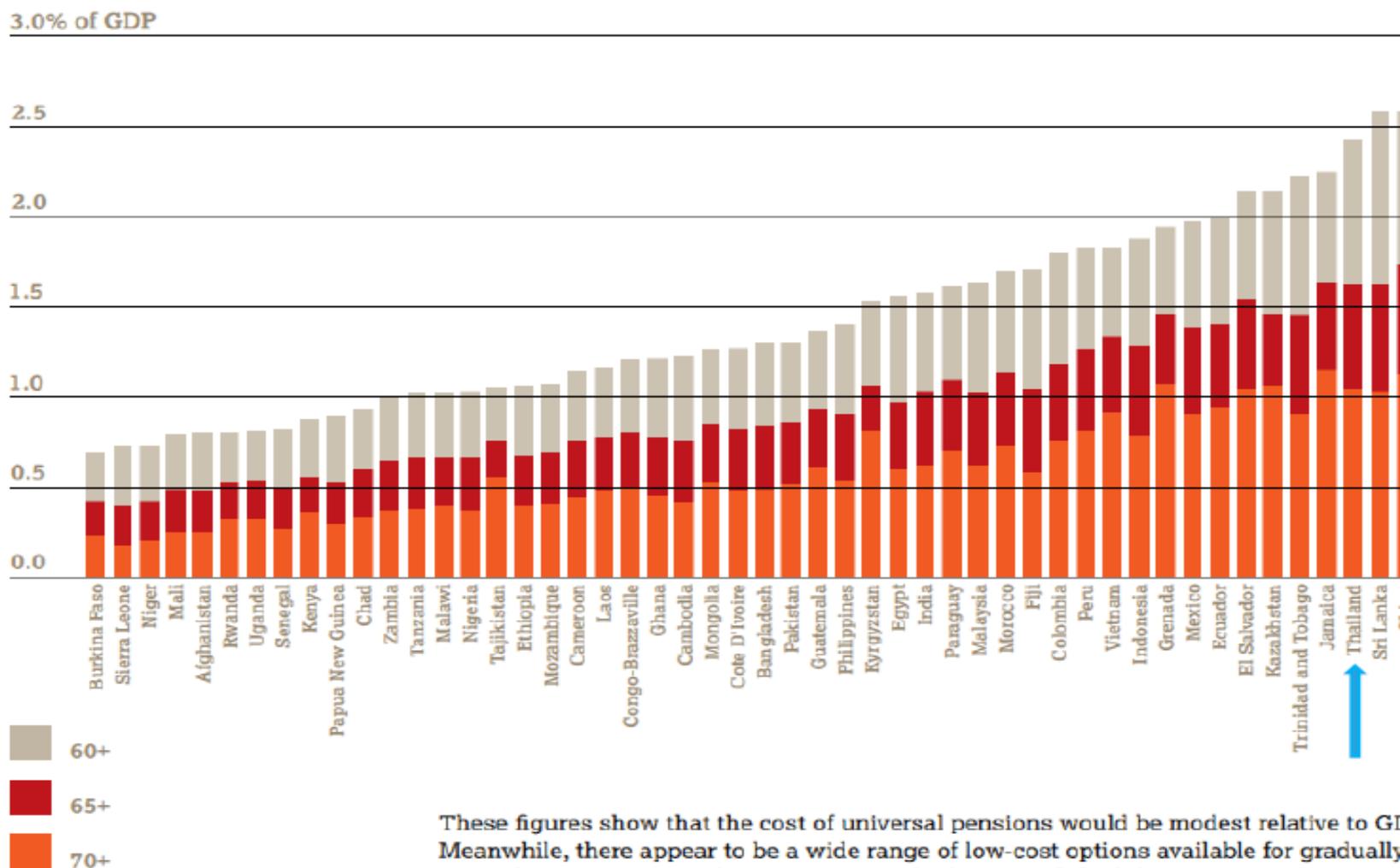
## SPF Gap Analysis - Vietnam



Source: Compatibility analysis of the national Social Protection Strategy and the UN Social Protection Floor Initiative: Costing and financial projections to implement social protection policies 2011-2020 (Draft), ILO, Geneva.

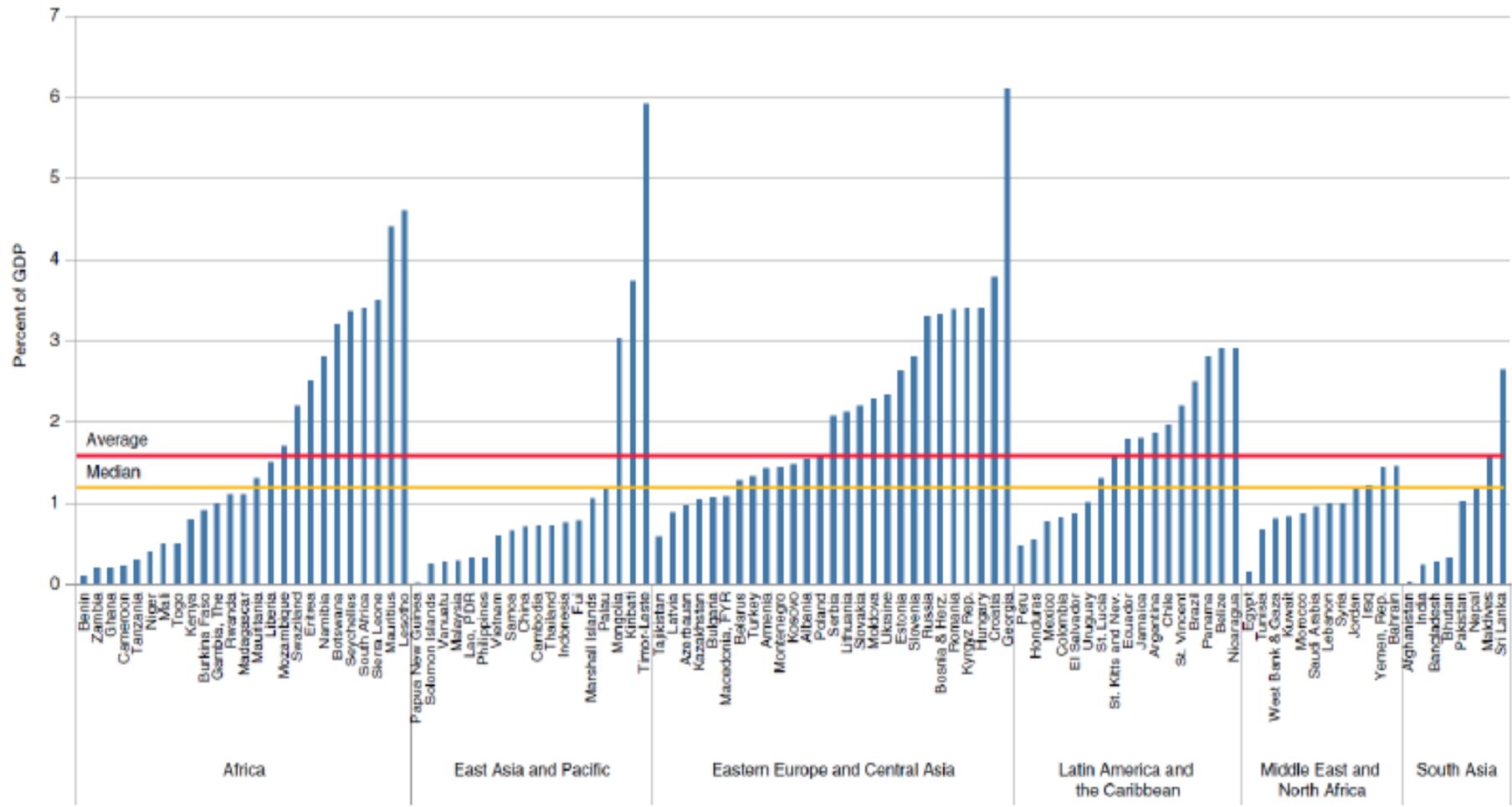
# Age Analysis – Universal Pensions

**Figure 1: Cost of a universal pension in 50 low- and middle-income countries**



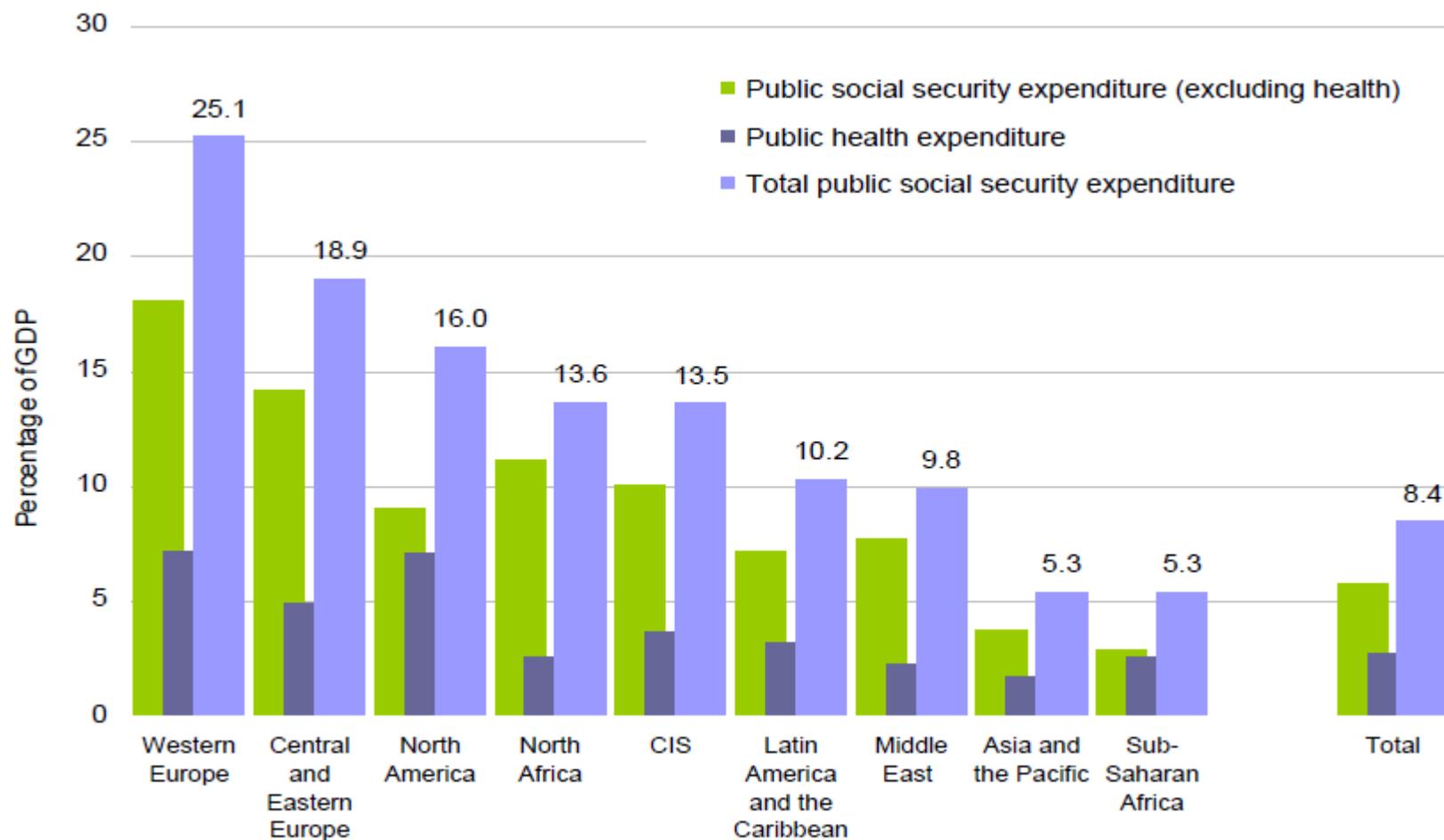
These figures show that the cost of universal pensions would be modest relative to GDP. Meanwhile, there appear to be a wide range of low-cost options available for gradually expanding coverage, such as starting at a higher age of eligibility.

# Cumulative SP Expenditure by Country



Source: World Bank 2014

## Comparative SP Expenditure by Region

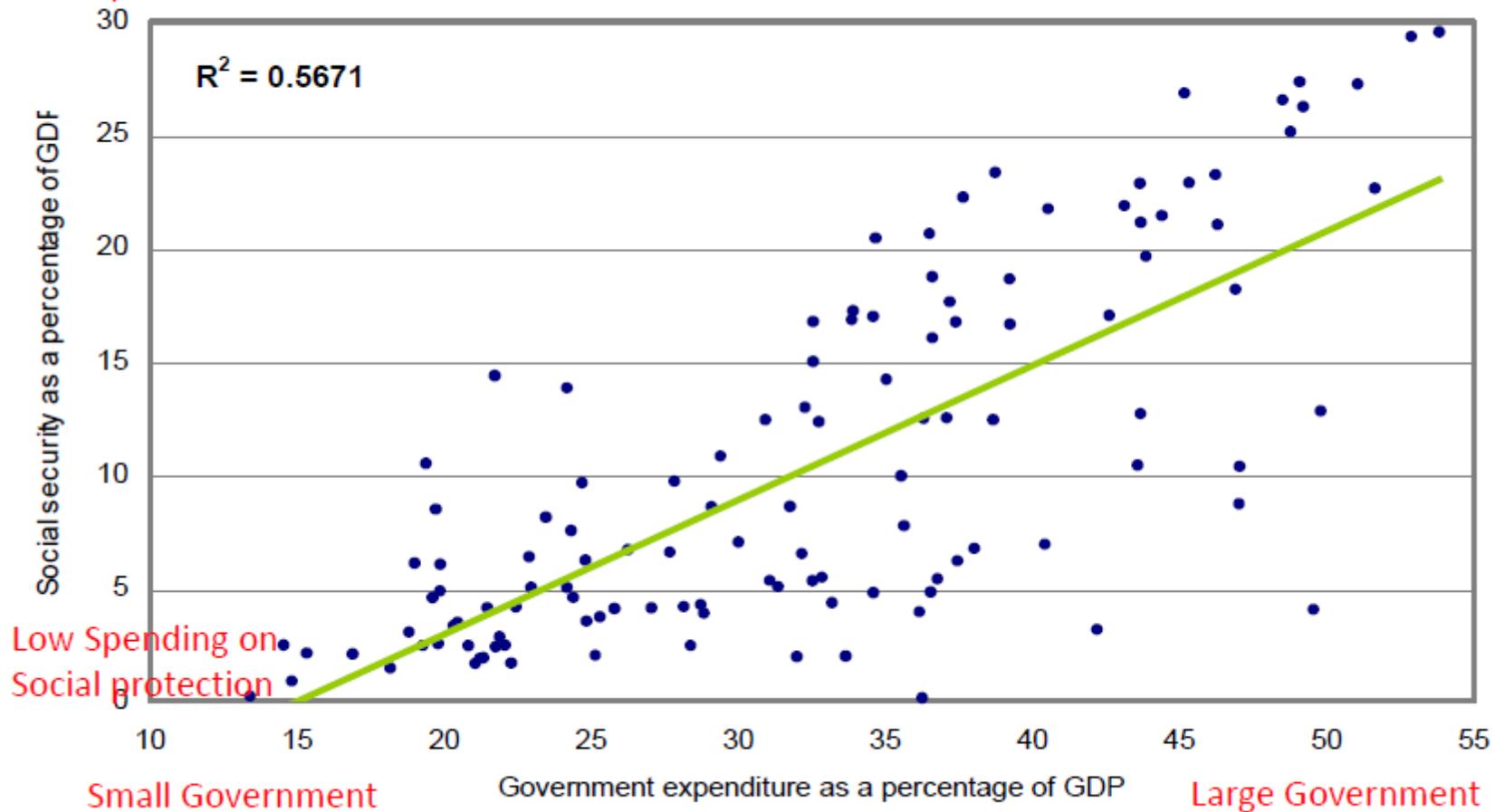


# Comparative SP Expenditure by Size



High Spending on  
Social protection

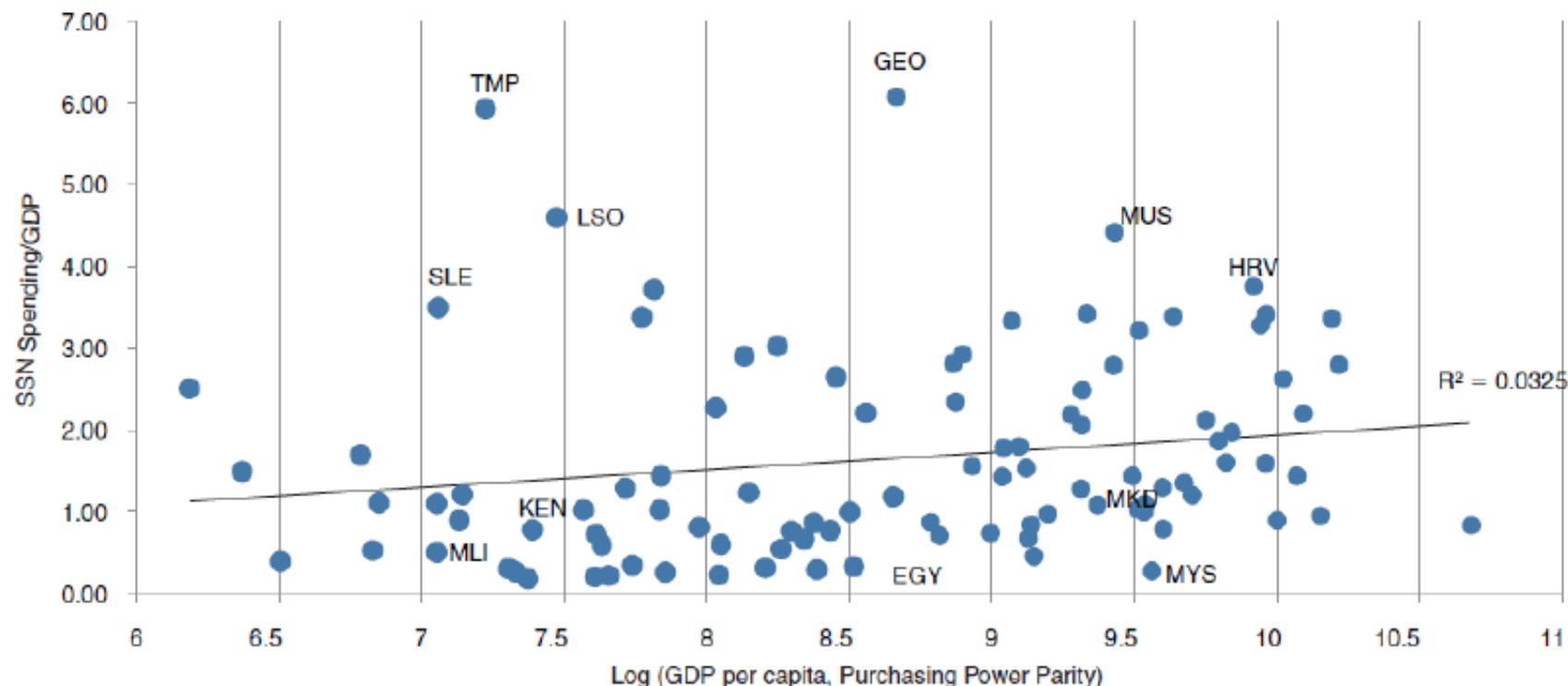
Source: ILO



# Comparative SP Expenditure by Size



**FIGURE 15** Social Safety Net Spending Is Not Always Commensurate with Country Level of Income



Source: Authors' calculations based on most recent spending data (annex 3) and GDP per capita, purchasing power parity USD of the respective year. Note: TMP—Timor-Leste; GEO—Georgia, LSO—Lesotho, SLE—Sierra Leone, MLI—Mali, KEN—Kenya, EGY—Egypt, MYS—Malaysia; MKD—Macedonia, Former Yugoslav Republic; FYR; MUS—Mauritius; HRV—Croatia.

Source: World Bank 2014

## Affordability

*“Affordability is a question of political choice about the best way to allocate resources” (Andrews et.al. 2012:26)*

- Social protection investments are long-term and recurrent investments
- Affordability depends on
  - Fiscal space
  - Political will and commitment
  - Policy priorities (competing, within and between sectors)
- Efficiency of SP program design, implementation and ongoing revisions is the core of the social protection impact paradigm

## Fiscal space

*“Fiscal space is the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of its financial position”*  
(Heller, 2005).

- Dynamic concept, subject to
  - Political priority setting
  - Short vs. Medium vs. Long-term planning
- Usually determined for 3-5 years (medium term)
- Can be created by cutting costs or increasing resources

## What determines fiscal space?

### Fiscal balance

Government revenues and grants minus government expenditures and net lending

### Fiscal balance

- Tax revenues (including social security contributions)
- Aid, concessional loans, -Government borrowing, -Reserves (e.g. wealth funds)
- Innovative financing (e.g. financial transaction tax)

### Prioritization/reallocation of resources

“A country’s ability to diversify tax income and economic activity determines the reliability of revenue streams and as such, fiscal space.” (HelpAge 2011b:4)

“Economic growth provides the easiest way to create fiscal space.” (Bachelet, 2011:67).

# Taxation

Guiding principle for financing social protection spending

- Government-driven
- Sustainable?
- Potential impacts of direct and indirect taxes need to be considered
- Progressive or regressive / -Fair tax burden -Distributional consequences

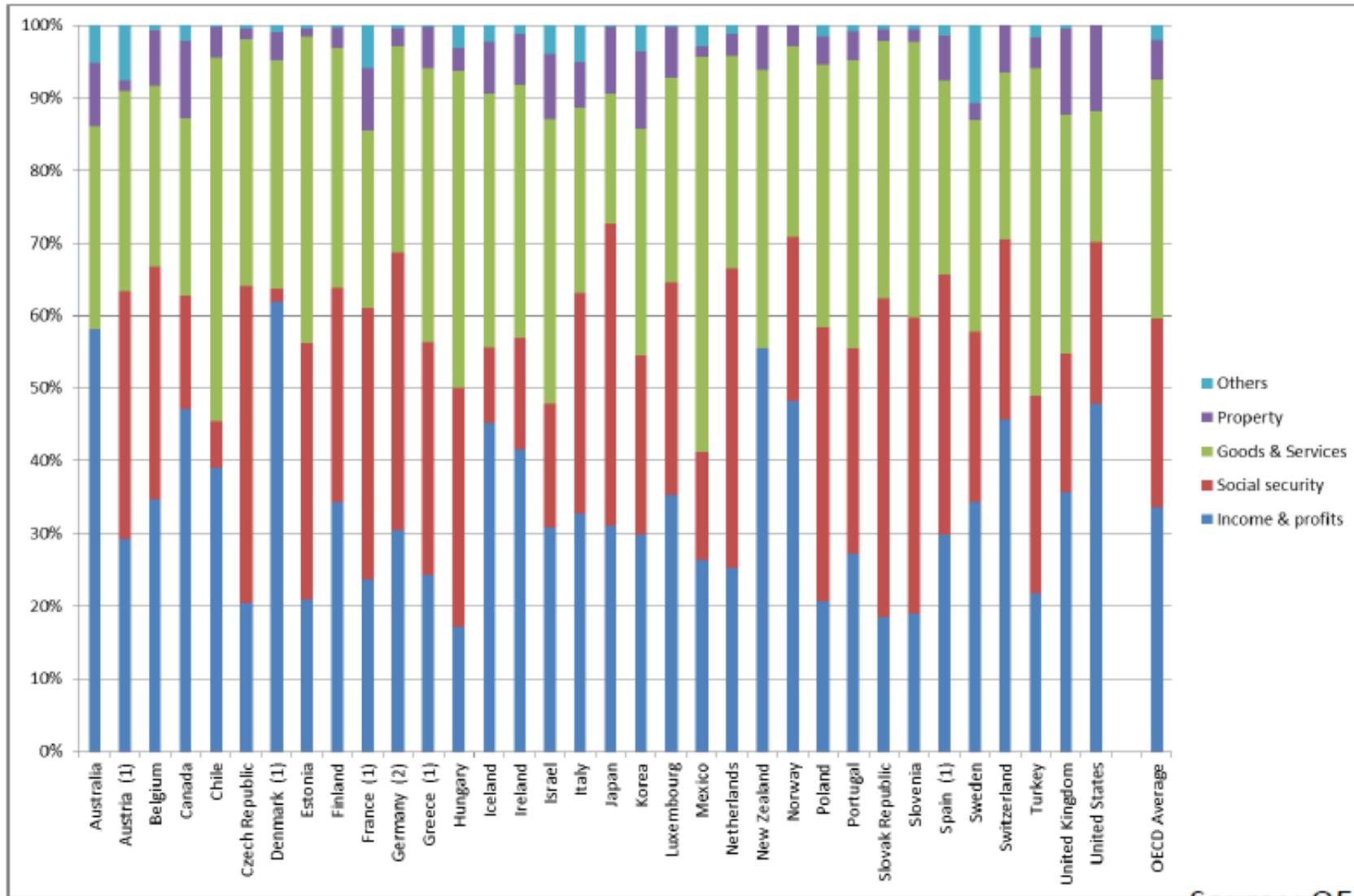
Challenges:

- Lack of administrative capacity, inadequate records
- General lack of trust in quality of public spending
- Reliance on narrow range of taxes (e.g. consumption (VAT), income, mineral taxes)
- Political economy

# Tax Revenue Sources of Select Countries



International



Source: OECD

## Tax Revenue Trends of Select Countries

Table 0.1. **Total tax revenue as a percentage of GDP for major non-OECD economies**

	1995	2000	2007	2008	2009 provisional
Argentina	20.0	21.5	29.1	30.7	31.4
Brazil	26.8	30.0	33.4	33.6	32.6
China <sup>1</sup>	9.8	14.5	20.7	22.0	n.a
India	14.6	14.5	18.9	17.3	15.7
Indonesia <sup>2</sup>	17.0	11.9 <sup>5</sup>	12.8 <sup>6</sup>	n.a	n.a
Russian Federation <sup>3</sup>	n.a	n.a	36.5	37.0	n.a
South Africa	25.0	26.5	30.8	29.8	27.6
<i>Unweighted average</i>					
<b>OECD Total<sup>4</sup></b>	<b>34.4</b>	<b>35.5</b>	<b>35.4</b>	<b>34.8</b>	<b>n.a</b>

n.a. Not available.

1. Figures for mainland China only excluding Hong Kong and Macao.

2. Figures for Central Government only.

3. Revenue and GDP figures obtained from Russian National Accounts.

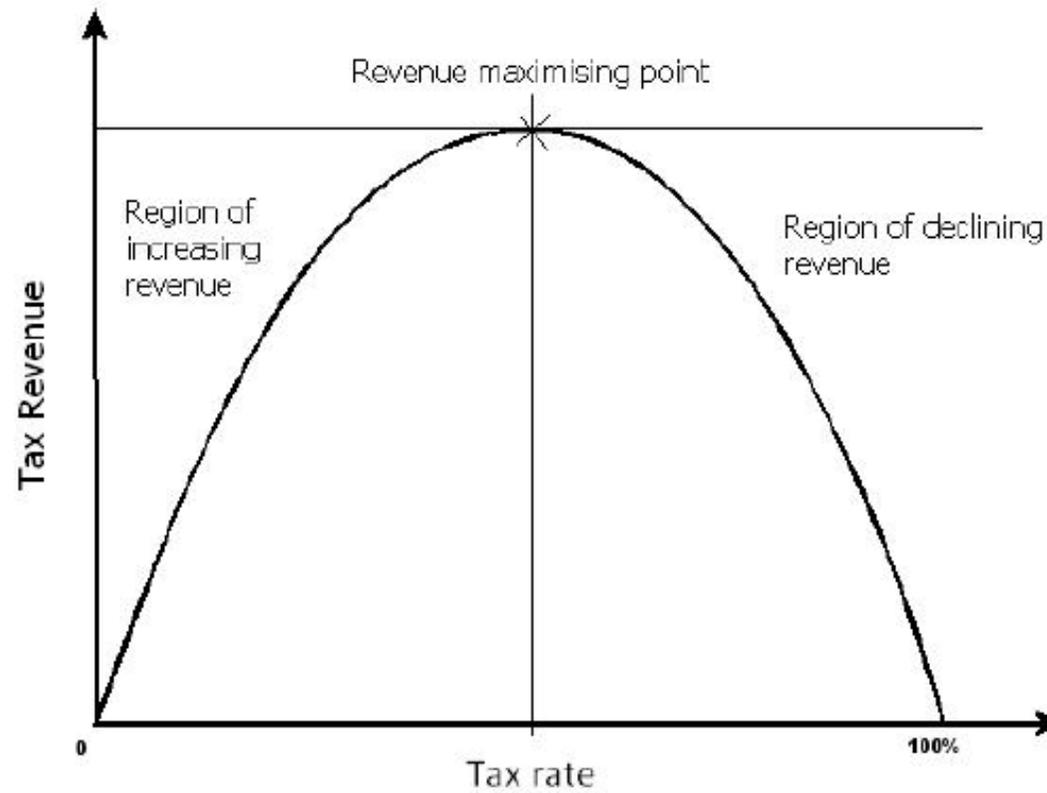
4. Excludes Estonia because the country was not an OECD member when this annual dataset was compiled.

5. 2001.

6. 2004.

Source: Brys et al. (forthcoming).

# Increasing Tax Rates is not the answer



## Social security contributions

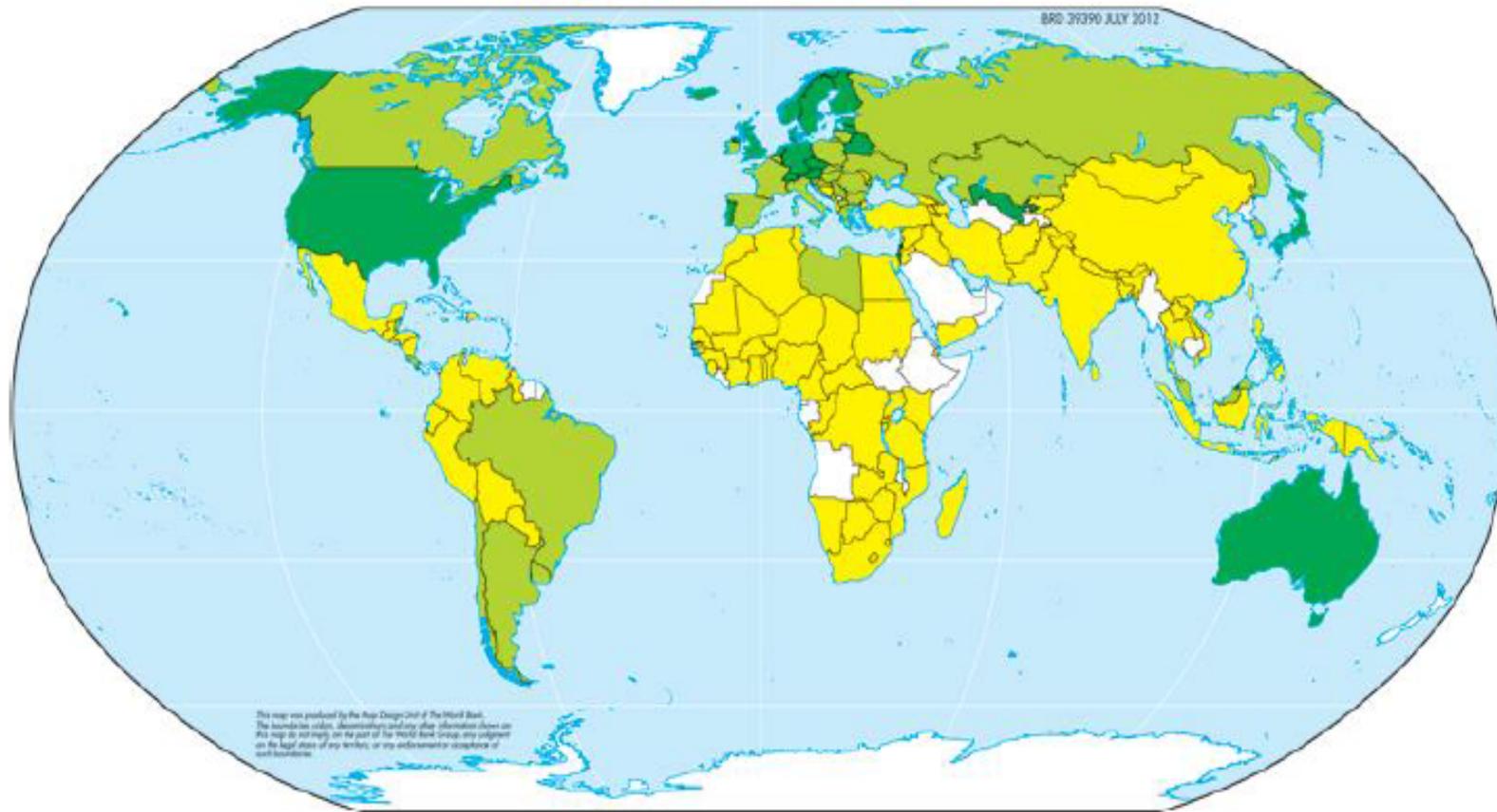
- Increasing coverage of contributions based SP is a reliable way to finance social protection (eg. Argentina, Brazil, Tunisia, Uruguay)
- Social security contributions also encourage formalization of the informal economy.
- The more workers are covered by formal social insurance schemes, the lower the need for non-contributory social protection in the future
- However, raising social security contributions contributes to total labor costs and can negatively affect employment and competitiveness of an economy

# Coverage of Formal Contributory Pension Schemes



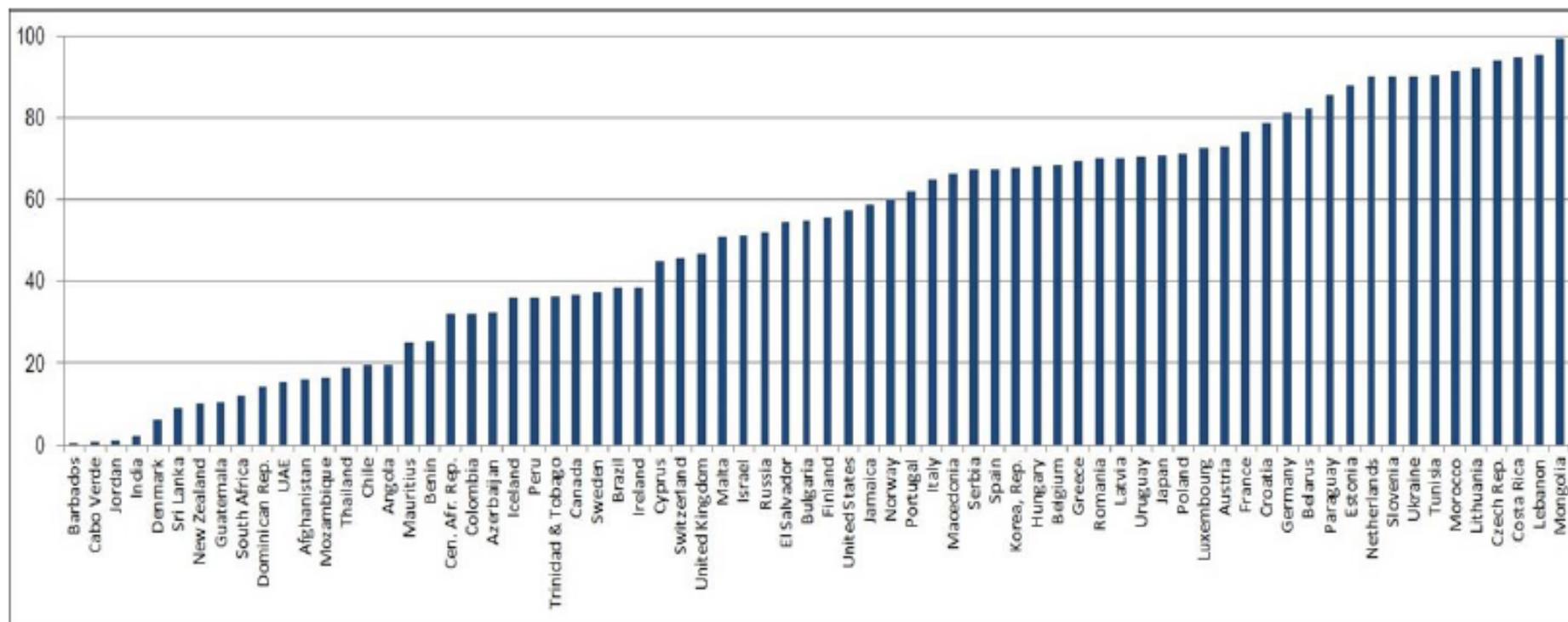
Active Members of Mandated Pension Schemes as % of Population Ages 15-64

9%-32.9%    33.0%-65.9%    66.0%-99.0%



Source: Worldbank

# Ratio of Social Security Contributions to Total SPF Expenditure



Source: Ortiz et al., 2015

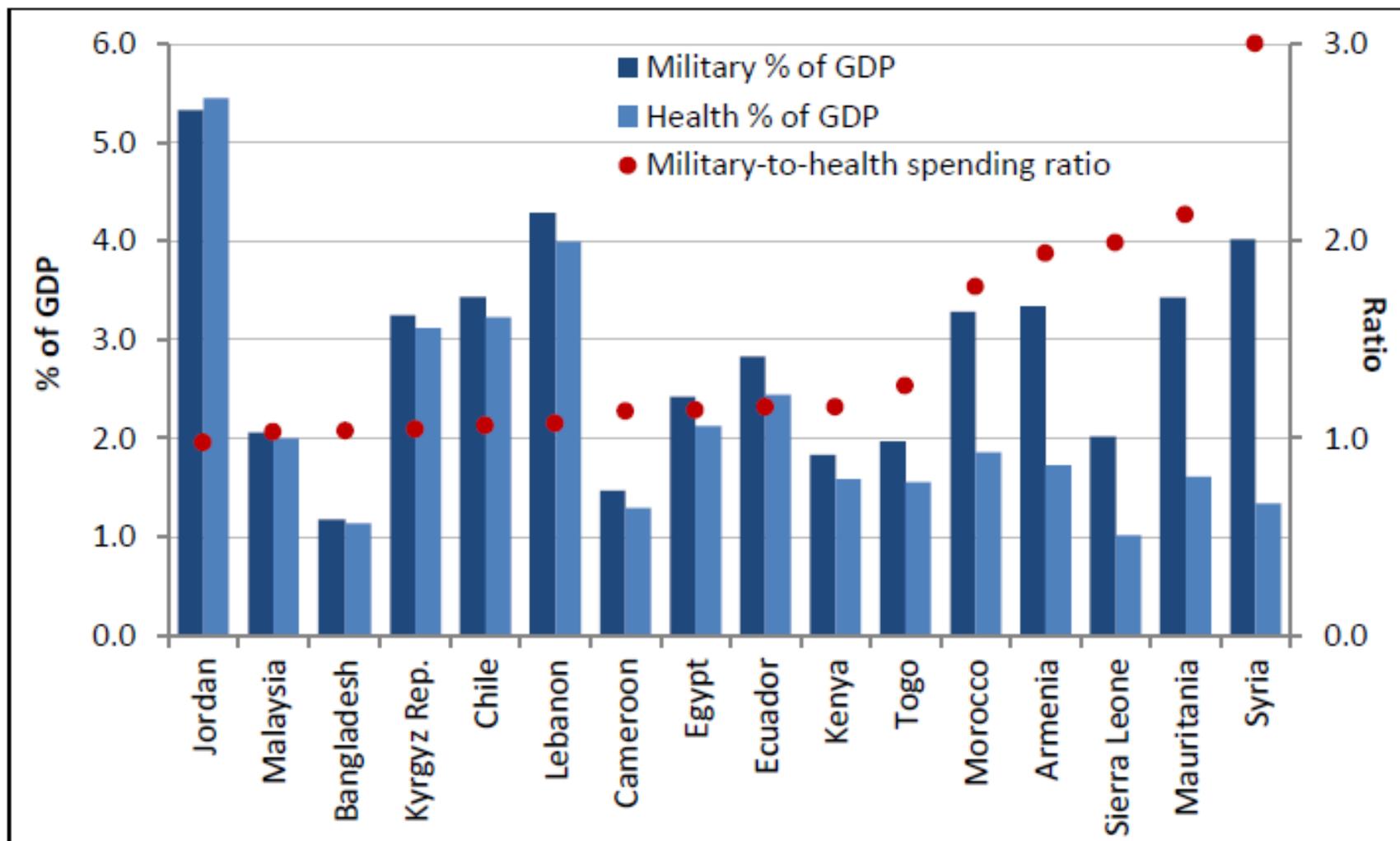
## Reallocation of resources

- Shift expenditures from inefficient or inequitable allocations
  - Mexico: social pension financed by reducing senior officials' travel and salaries
- Reduce unproductive spending, especially if it is recurrent

### Considerations:

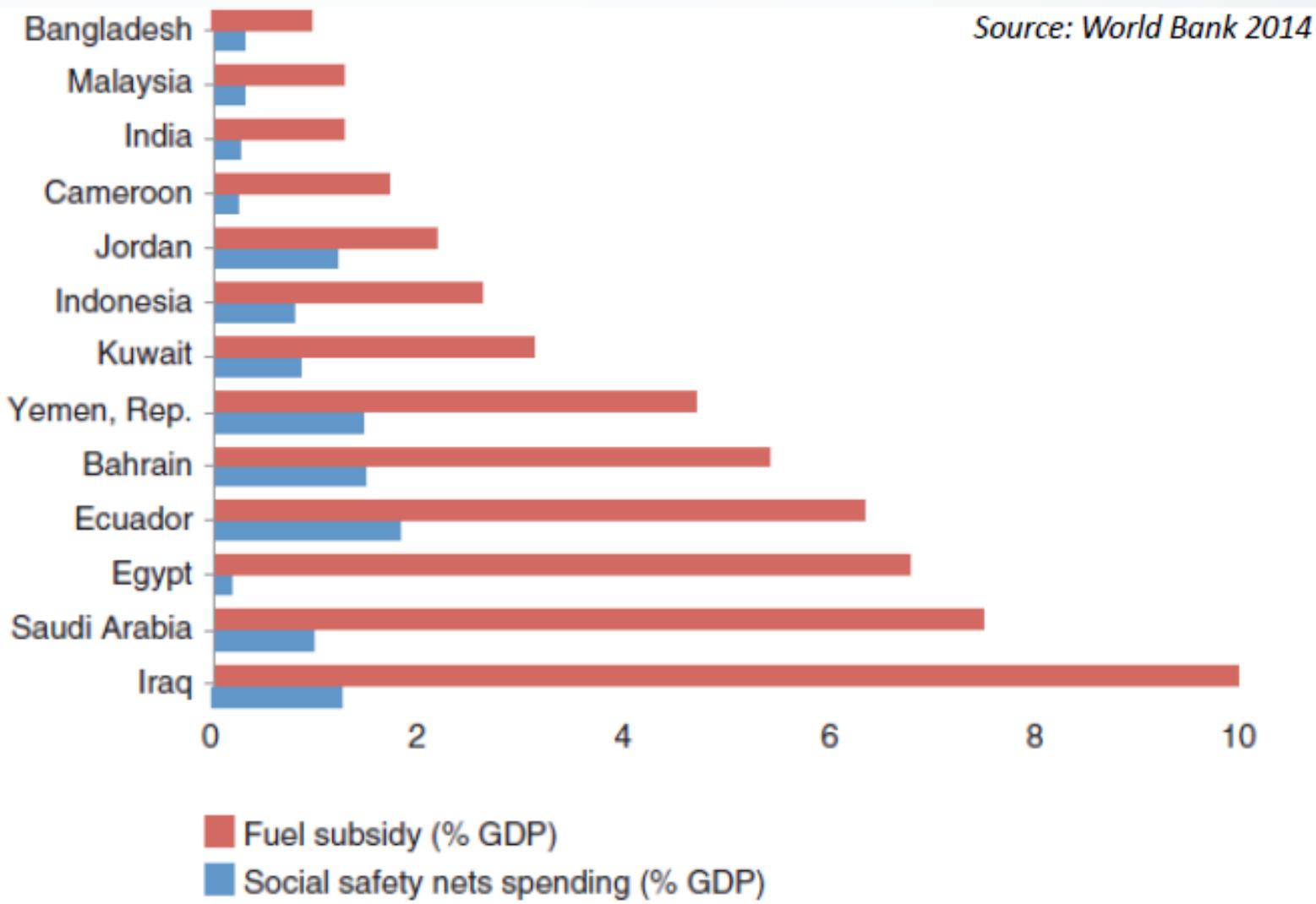
- Balance spending in and between sectors
- Annual reallocation margins generally small

## Ratio of Health vs. Military Expenditure



Source: Ortiz and Cummins, 2012

# Ratio of SP vs. Fuel Subsidy Expenditure



## Successful reallocation of resources

**El Salvador:** Savings from removal of untargeted energy subsidies used to increase social spending (Bachelet, 2011:46).

**Indonesia:** CCTs mainly financed by gradual reprioritization of social expenditure (Bachelet, 2011:69).

**South Africa:** 48% decrease in defense spending made funding of social programs from public resources possible (Bachelet, 2011:69).

**Costa Rica and Thailand:** Reallocated military expenditures for universal health (Ortiz et al. 2015)

**Egypt:** Created an Economic Justice Unit in the Ministry of Finance to review expenditure priorities (Ortiz et al. 2015)

**Mozambique:** elimination of subsidies on fuel, bread and other regressive measures could help finance basic SP programs (Bachelet, 2011:46).



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## Official Development Assistance

Important for initial direct funding of SP programs, especially in LICs

- Support of development of institutions and administrative capacity
- Support of pilots

Special case: Debt relief

- Explicitly link to social protection
- Can free up fiscal space

Challenges

- Sustainability
  - if insufficient government ownership and capacity
  - If (pilot) transfers not translated into wider program design
- ODA often inflexible and unreliable;
- Transaction costs can be high



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## Innovative financing

### Financial transaction tax

- Tax on share trades
- Raises less than 0.5% of GDP on average, but potential to yield 48 billion USD/year in G20
- Assisted Brazil to consolidate health system

### Global currency transaction tax

- 0.005% tax on FEX transactions could raise up to 36 billion USD/year for 4 major currencies

### Solidarity levy on airline tickets

- Brazil, France, Norway and UK agreed to tax airline tickets and support basic health protection in LICs
- 1 – 40 USD/ticket
- Since 2006, 2 billion USD collected; funded programs in 94 countries

# Policy Strategies to Increase Fiscal Space



Strategy	Bolivia	Botswana	Brazil	Costa Rica	Lesotho	Namibia	South Africa	Thailand
Mineral-based taxation or similar taxes for specific purposes (earmarked taxation)	X	X	X					
Increasing general taxation			X		X			X
Increasing Social contributions			X	X	X	X	X	X
Budget surpluses		X	X			X		
Budget redefinition. Reduction of non-priority spending or decline of military expenditure				X	X		X	X
Reduction in national debt and in debt servicing	X	X	X	X	X		X	X
Official Development Assistance						X		
Sale of state assets	X							
Gains of efficiency			X					
Amendment of the Constitution			X	X			X	X

## Remittance vs. SP Spending



**TABLE 3:** Remittances Inflows Are Higher Than Social Safety Nets Spending in Low-Income Countries

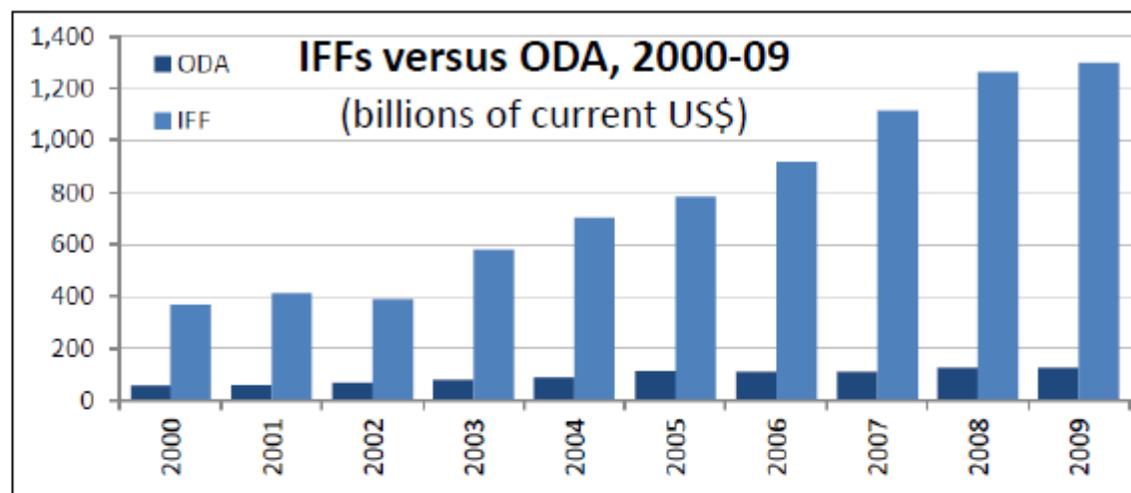
	Social Safety Net Spending (\$ billions)	Remittances Inflows (\$ billions)
Low-income countries (20)	3.6	28.4
Lower-middle-income countries (34)	38.0	186.3
Upper-middle-income countries (39)	196.9	135.0
High-income countries (14)	98.9	19.7
<b>Total (107)</b>	<b>337.4</b>	<b>369.5</b>

Source: World Bank 2014

## IFF vs. SP Spending

### Illicit Financial Flows (IFFs)

Main components:  
 (i) trade mispricing (ii) tax evasion



Country	IFFs (2005-08 avg. annual value)	Public health spending (2009 or latest available)	Country	IFFs (2005-08 avg. annual value)	Public health spending (2009 or latest available)
Panama	29.4	5.9	Nigeria	17.0	2.1
Seychelles	29.3	3.1	Lao PDR	15.5	0.8
Malaysia	28.1	2.2	Estonia	15.3	5.3
Guinea	26.7	0.9	Philippines	15.1	1.3
Honduras	26.6	3.4	Venezuela	12.8	2.4
Costa Rica	26.3	7.1	Madagascar	12.0	2.8
Kazakhstan	25.1	2.7	Zimbabwe	11.9	...
Azerbaijan	22.1	1.4	China	11.6	2.3
St. Vincent	21.3	3.2	Namibia	11.4	4.0
Samoa	20.7	6.1	Bulgaria	11.4	4.4
Nicaragua	20.5	5.4	Belarus	11.1	4.1
Djibouti	18.6	5.3	Mali	10.8	2.7
Trinidad & Tob.	17.9	2.7	Lithuania	10.7	4.5
Slovenia	17.7	6.4	Ukraine	10.6	3.8

**Exporting Illicit Capital and Health Spending**  
 (% of GDP, latest available)

## Strategies to ensure sustainability of SP systems

- Stimulate economic growth, formalize economy, enhance productive employment
- Create necessary fiscal space
- Continuous political will
- Cost-control mechanisms
- Effective institutions (administrative capacity)
- Sound implementation and good governance, including M&E
- Budget for long transition period wherein SP spending is increased
  - Sequential introduction of different transfers
- Start with limited coverage, small benefit levels and expand over time

## Sectoral & SP Spending Targets



<b>Sector</b>	<b>Agreement</b>	<b>Explicit Spending Target</b>	<b>Target</b>
Social protection	Social Policy Framework for Africa (2008)	No	4.5% GDP
Health	Abuja Declaration (2001)	Yes	15% Govt. expend.
Education	Education for All Initiative (2000)	Yes	20% Govt. expend.
Water and sanitation	eThekwini Declaration (2008)	No (water)	1.5% GDP
	Sharm El-Sheik Commitment (2008)	Yes (sanitation)	
Agriculture	Maputo Agreement (2003)	Yes	10% Govt. expend.
Infrastructure	African Union Declaration (2009)	No	9.6% GDP

Note: Explicit Spending Targets are those for which the expenditure target is specified in the agreement. For the other targets the objectives outlined in the agreement are matched with an appropriate costing study.

## Sectoral & SP Spending Targets vs. Actual



Sector	Target	Ethiopia	Kenya	Malawi	Mozambique	Uganda
	<i>% government expenditure or % GDP (as applicable)</i>					
Social Protection	4.5 GDP	0.7	0.3	0.4	0.1	0.1
Health	15 Govt. expend.	6.6	5.2	16.4	13.6	7.2
Education	20 Govt. expend.	23.6	19.9	14.4	20.1	16.2
Water and sanitation	1.5 GDP	0.4	0.5	0.2	0.6	0.3
Agriculture	10 Govt. expend.	9.9	3.0	15.5	4.2	3.5
Infrastructure	9.6 GDP	3.6	3.0	1.9	3.5	1.7

Note: Shading indicates that target has been met.

Source: Own calculations based on government budgets

## Conclusion

- Social protection is no longer seen as a cost to the economy, but as a source of resilience in tough times and as support for growth and productivity in good times
- Political (affordability) as well as fiscal (cost) considerations determine the scope of options for SP programs.
- Fiscal space is country-context specific as it depends on political priorities and macro-economic conditions.
- Domestic social and political priorities remain critical issues.
- Financing option is the outcome of political debate, decisions and technical considerations.
- Issues of fiscal sustainability are important given the budget variances (over time), and intense competition from other sectors.
- It is better to start small, keep objectives moderate in the short-run, and expand the provision of social protection over time.