

# Fiscal Space for Social Protection: Options Exist even in the Poorest Countries

Eight Options to Expand Social Investments in 187 Countries

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## Fiscal space exists even in the poorest countries

*“The world does not lack the resources to eradicate poverty, it lacks the right priorities.”*

*Juan Somavia, former Director General of the ILO*

It is often argued that social protection is not affordable or that government expenditure cuts are inevitable during adjustment periods. But there are alternatives, even in the poorest countries. In fact, there is a wide variety of options to expand fiscal space and generate resources for social investments. The eight financing options described in this brief are supported by policy statements of the United Nations and international financial institutions. Many governments around the world have been applying them for decades, showing a wide variety of revenue choices as well as creativity to address vital social investment gaps.

**1. Re-allocating public expenditures:** This is the most orthodox approach, which includes assessing ongoing budget allocations through Public Expenditure Reviews (PERs) and other types of thematic budget analyses, replacing high-cost, low-impact investments with those with larger socio-economic impacts, eliminating spending inefficiencies and/or tackling corruption. For example, Egypt created an Economic Justice Unit in the Ministry of Finance to review expenditure priorities, and Costa Rica and Thailand shifted military spending to finance universal health services.

**2. Increasing tax revenues:** This is clearly the principal channel for generating resources, which is achieved by altering different types of tax rates—e.g. on consumption, corporate profits, financial

### Key messages

There is national capacity to fund social protection in virtually all countries. There are many options, supported by UN and IFIs policy statements:

1. Re-allocating public expenditures
2. Increasing tax revenues
3. Expanding social security coverage and contributory revenues
4. Lobbying for aid and transfers
5. Eliminating illicit financial flows
6. Using fiscal and foreign exchange reserves
7. Borrowing or restructuring existing debt
8. Adopting a more accommodative macroeconomic framework.

activities, property, imports/exports, natural resources—or by strengthening the efficiency of tax collection methods and overall compliance. Many countries are increasing taxes for social investments, not only on consumption, which is generally regressive and counter to social progress, but also on other areas. For example, Bolivia, Mongolia and Zambia are financing universal pensions, child benefits and other schemes from mining and gas taxes; Ghana, Liberia and the Maldives have introduced taxes on tourism to support social programs; and Brazil introduced a tax on financial transactions to expand social protection coverage.

**3. Expanding social security coverage and contributory revenues:** Increasing coverage and therefore collection of contributions is a reliable way

**Table 1. Examples of fiscal space strategies in selected countries**

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

to finance social protection, freeing fiscal space for other social expenditures; social protection benefits linked to employment-based contributions also encourage formalization of the informal economy, a remarkable example can be found in Uruguay's Monotax. Argentina, Brazil, Tunisia and many others have demonstrated the possibility of broadening both coverage and contributions.

**4. Lobbying for aid and transfers:** This requires either engaging with different donor governments or international organizations in order to ramp up North-South or South-South transfers. Despite being much smaller than traditional volumes of ODA, bilateral and regional South-South transfers can also support social investments and warrant attention.

**5. Eliminating illicit financial flows:** Estimated at more than ten times the size of all ODA received, a titanic amount of resources illegally escape developing countries each year. To date, little progress has been achieved, but policymakers should devote greater attention to cracking down on money laundering, bribery, tax evasion, trade mispricing and other financial crimes that are both illegal and deprive governments of revenues needed for social and economic development.

**6. Using fiscal and central bank foreign exchange reserves:** This includes drawing down fiscal savings and other state revenues stored in special funds, such as sovereign wealth funds, and/or using excess foreign exchange reserves in the central bank for domestic and regional development. Chile, Norway and Venezuela, among others, are tapping into fiscal reserves for social investments.

**7. Borrowing or restructuring existing debt:** This involves active exploration of domestic and foreign borrowing options at low cost, including concessional, following careful assessment of debt sustainability. For example, South Africa issued municipal bonds to finance basic services and urban infrastructure. For countries under high debt distress, restructuring existing debt may be possible and justifiable if the legitimacy of the debt is questionable and/or the opportunity cost in terms of worsening deprivations of vulnerable groups is high. In recent years, more than 60 countries have successfully renegotiated debts, and more than 20 have defaulted/repudiated public debt, such as Ecuador, Iceland and Iraq, directing debt servicing savings to social programs.

**8. Adopting a more accommodating macroeconomic framework:** This entails allowing for higher budget

deficit paths and/or higher levels of inflation without jeopardizing macroeconomic stability. A significant number of developing countries have used deficit spending and more accommodative macroeconomic frameworks during the global recession to attend to pressing demands at a time of low growth and to support socio-economic recovery.

Each country is unique, and all options should be carefully examined, including the potential risks and trade-offs, and considered in national social dialogue. Given the importance of public investments for human rights and inclusive development, it is imperative that governments explore all possible alternatives to expand fiscal space to promote national socio-economic development with jobs and social protection.

#### **Social dialogue: Fundamental to generate political will to exploit all potential options**

National social dialogue is best to articulate optimal solutions in macroeconomic and fiscal policy, the need for job and income security and human rights. While in some countries, national development strategies and their financing sources have been shaped through social dialogue, in many other countries this has not been the case. Public policy decisions have often been taken behind closed doors, as technocratic solutions with limited or no consultation, resulting in reduced social investments, in lack of public ownership, adverse socio-economic impacts and, frequently, civil unrest.

National tripartite dialogue, with government, employers and workers as well as civil society, academics, United Nations agencies and others, is fundamental to generate political will to exploit all possible fiscal space options in a country, and adopt the optimal mix of public policies for inclusive growth and social justice.

Questions to consider on fiscal space options during national dialogue include:

**i. Reprioritizing Public Spending: *Can government expenditures be re-allocated to support social investments that empower vulnerable households?*** Are, for example, current military, infrastructure or commercial sector expenditures justified in light of existing poverty rates? Has a recent study been conducted to identify measures to enhance the efficiency of current investments, including steps to tackle and prevent corruption and the mismanagement of public funds?

**ii. Increasing tax revenues:** *Have all taxes and possible modifications been considered to maximize public revenue without jeopardizing private investment?* Are personal income and corporate tax rates designed to support equitable development outcomes? What specific collection methods could be strengthened to improve overall revenue streams? Could minor tariff adjustments increase the availability of resources for social investments? Is natural resource extraction adequately taxed? Can tax policies better respond to “boom” and “bust” cycles? Have financial sector taxes been considered to support productive and social sector investments? Has there been any attempt to earmark an existing tax or introduce a new one to finance specific social investments – taxes on property, inheritances, tourism, tobacco, etc.?

**iii. Expanding social security coverage and contributory revenues:** *What is the percentage of workers contributing to social security?* Can contributions to social security be extended to more workers? Are current contribution rates adequate? Is there scope to introduce innovations (e.g. like Monotax in Latin America) to encourage the formalization of workers in the informal sector?

**iv. Lobbying for increased aid and transfers:** *Has the government delivered a convincing case to OECD countries for increased aid, including budget support, to support the scaling up of social investments?* Has there been any formal or informal attempt to lobby neighboring or friendly governments for South-South transfers?

**v. Eliminating illicit financial flows:** *Has a study been carried out or a policy designed to capture and re-channel illicit financial flows for productive uses?* What can be done to curb tax evasion, money laundering, bribery, trade mispricing and other financial crimes are illegal and deprive governments of revenues needed for social and economic development?

**vi. Using fiscal and foreign exchange reserves:** *Are there fiscal reserves, for example, sitting in sovereign wealth funds that could be invested in poor households today?* Are excess foreign exchange reserves being maximized and used to foster local and regional development?

**vii. Borrowing or restructuring debt:** *Have all debt options been thoroughly examined to ramp up social investments?* What are the distributional impacts of financing government expenditures by additional borrowing? Have different maturity and repayment terms been discussed with creditors? Has a public audit been carried out to examine the legitimacy of existing debts?

**viii. Adopting a more accommodating macroeconomic framework:** *Is the macroeconomic framework too constrictive for national development?* If so, at what cost macroeconomic stability? Could increasing the fiscal deficit by a percentage point or two create resources that could support essential investments for the population? Are current inflation levels unduly restricting employment growth and socio-economic development?

**Lastly, have all options been carefully examined and discussed in an open social dialogue?** Have all possible fiscal scenarios been fully explored? Is there any assessment missing from the national debate? Are all relevant stakeholders, government, employers, workers, civil society, academics, United Nations agencies and others, being heard and supportive of an agreement that articulates an optimal solution in macroeconomic and fiscal policy, the need for job and income security and human rights?

A good starting point for country level analysis is a summary of the latest fiscal space indicators for 187 countries, available in Annex I of ["Fiscal Space for Social Protection: Options to Expand Social Investments in 187 Countries"](#).

This policy brief is based on the working paper [“Fiscal Space for Social Protection: Options to Expand Social Investments in 187 Countries”](#) by Isabel Ortiz, Matthew Cummins and Kalaivani Karunanethy, published by the International Labour Organization, Geneva: 2015

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