Financing social protection: issues and practices

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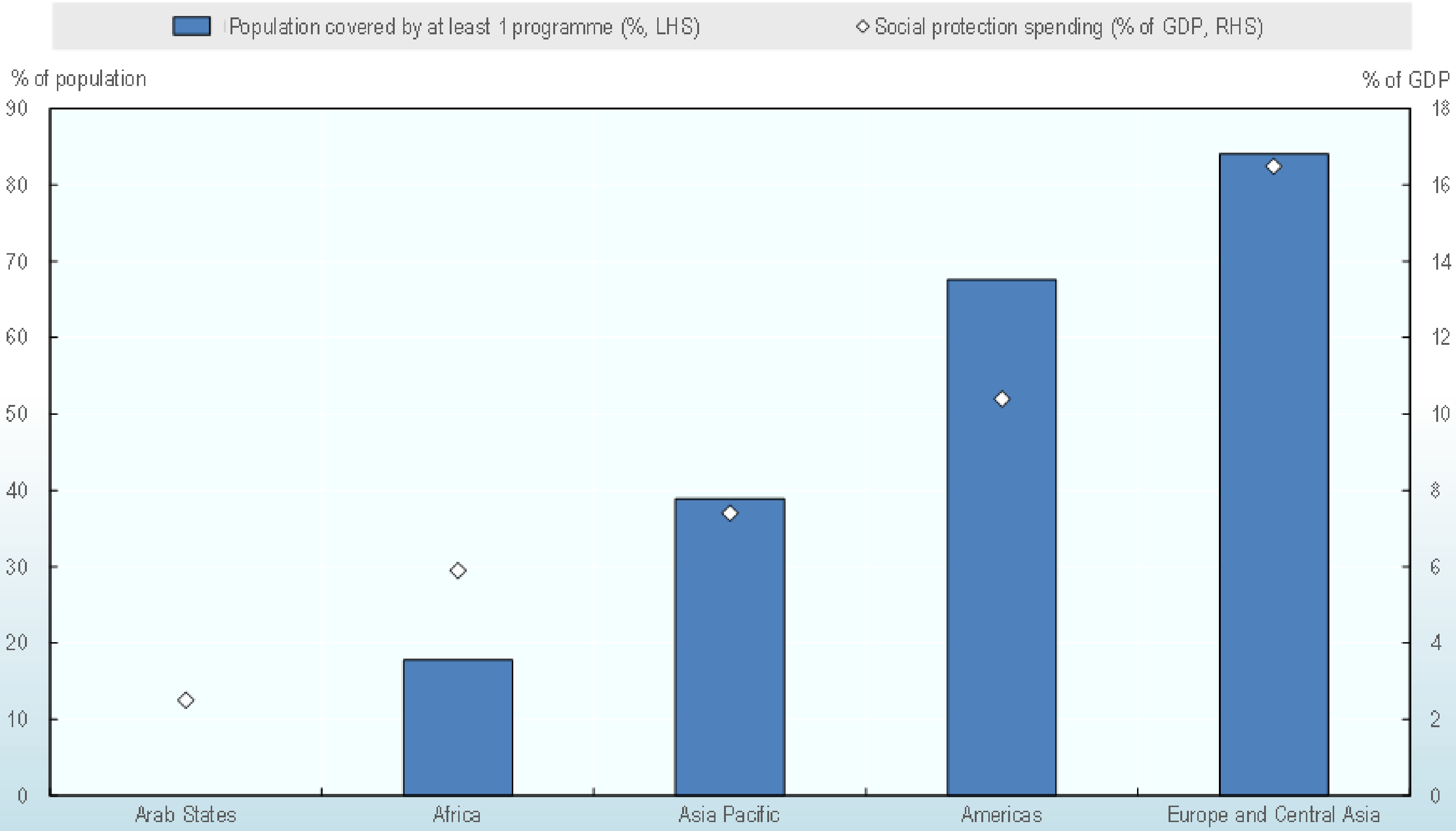
Outline

1. Why financing for social protection?
2. A quick introduction to tax
3. Tax systems: Important and not *that* complicated
4. Financing strategies for social protection in three easy steps
5. Fiscal incidence analysis
6. Quick case studies – Kyrgyzstan and Ethiopia
7. Final thoughts

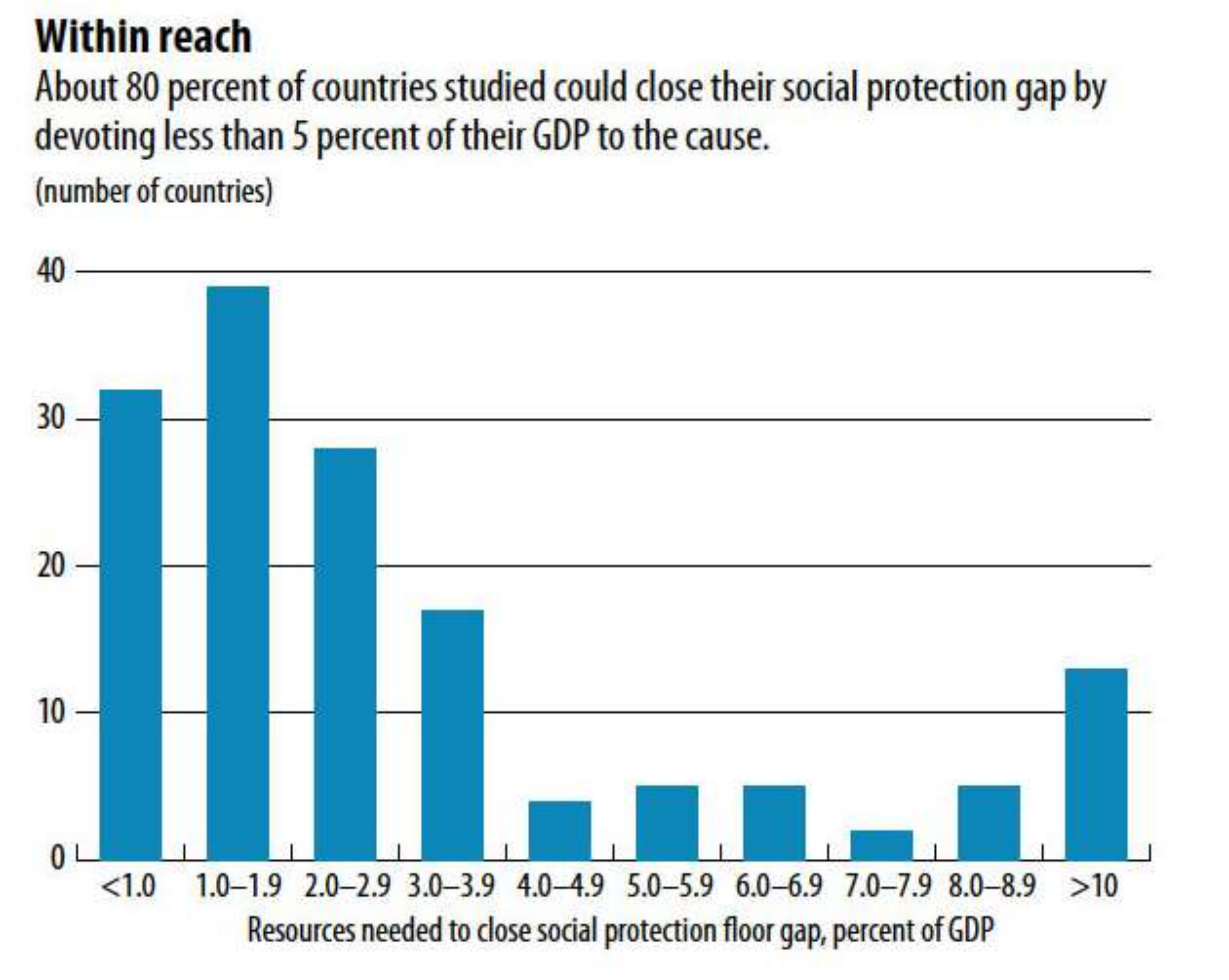
WHY FINANCING FOR SOCIAL PROTECTION?

Social protection spending is far too low globally



Source: ILO World Social Protection Report 2017-19

Is it really affordable for all?



Source: Cichon (2018) Hardly anyone is poor to share – based on results from the FES Social Protection Floor Index

What's different about financing social protection?

- Social protection programmes work best when they are reliable and pay adequate benefits that retain their value
- National social protection programmes can be expensive
- Politically, they can be very difficult to eliminate
- Contributory schemes create long-term obligations
- Demand for social protection increases during the bad times
- Social protection programmes are often aimed at specific vulnerable groups

What does this mean for financing?

- Sources of financing must be regular, significant and sustainable

- Fiscal policy should be counter-cyclical
  - Very rare in developing countries but key to OECD response to financial crisis

- Tax incidence (who pays) matters

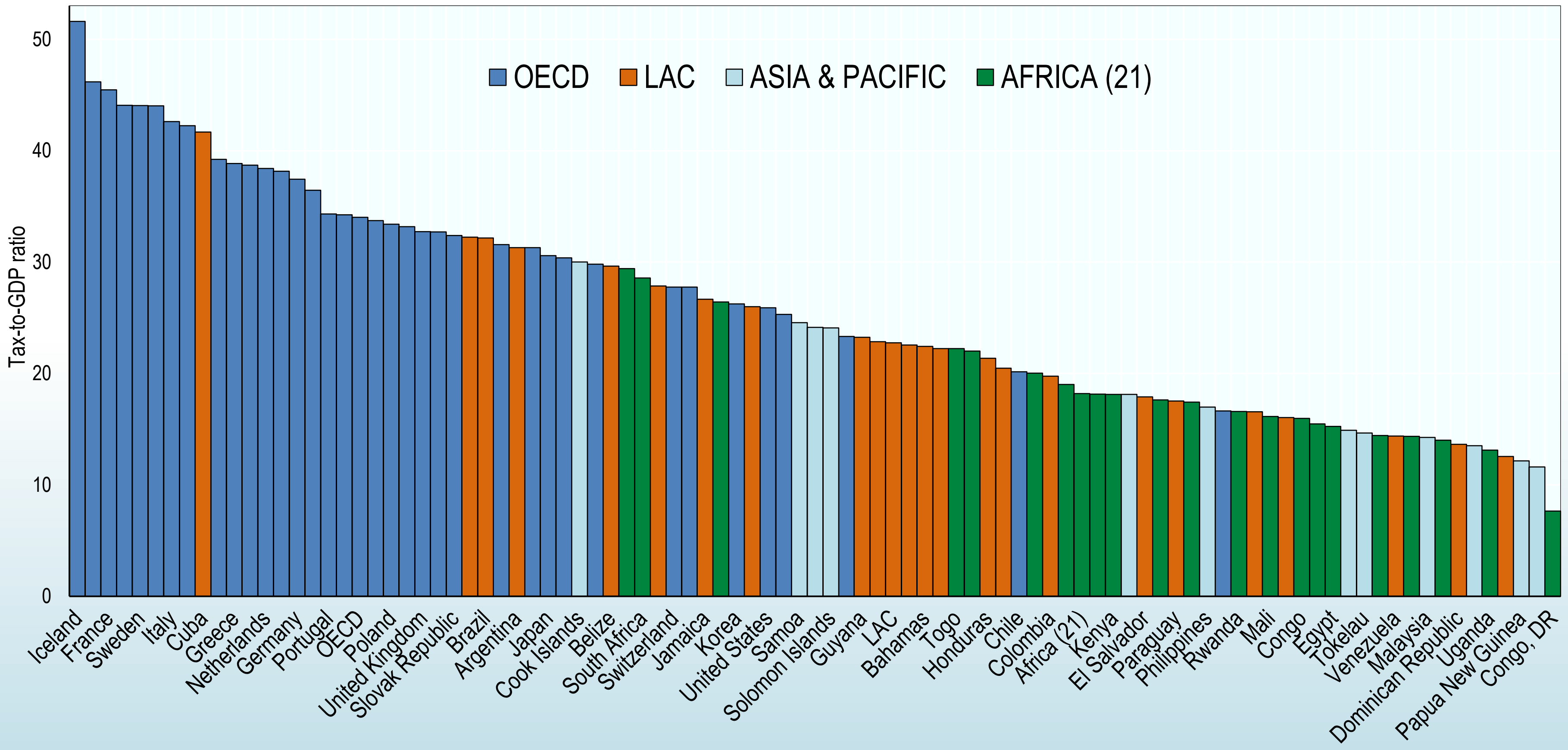
- Contributory schemes have a key role to play in financing (adequate) benefits and responding automatically to the bad times…

- …but their long-term implications needs monitoring otherwise they become part of the problem

A QUICK INTRODUCTION TO TAX

Global tax levels

Tax-to-GDP ratios by country & region, 2016



Source: OECD Global Revenue Statistics Database

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What do tax-to-GDP ratios tell us?

- Taxes finance public expenditure: the higher public revenues, the more governments can afford to spend
- High-income countries tend to have significantly higher tax-to-GDP ratios than middle-income countries
- Difference in tax-to-GDP ratios between low- and middle-income countries is much less evident
  - OECD average in 2017 was 34%, Latin America 23%, Africa 17%
- (Remember, different sources calculate tax-to-GDP ratios differently – important to compare using same methodology)

…and what do they not?

- The tax-to-GDP ratio doesn't cover all public revenues
- It doesn't tell you who pays which taxes and how much they pay
- It doesn't tell you whether tax revenues are growing faster or slower than GDP
- It doesn't reflect the (increasingly important) international aspect of taxation
- It doesn't show the economic, social and political history that underpin the tax system

Peter the Great

TAX SYSTEMS: IMPORTANT AND NOT *THAT* COMPLICATED

Meet Vinicios Leoncio

What are the main tax types?

Taxes on income and profits	• Individuals (income and profits, capital gains) • Corporations
Social security contributions	• Employers, employees and self-employed
Taxes on payroll	• Employers, employees
Taxes on property	• Recurrent taxes on immovable property • Estate, inheritance and gifts; financial transactions
Taxes on goods and services	• Value-added tax, excises and trade taxes
Other taxes	

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Indirect taxes

Source: OECD Interpretative Guide

Direct taxes better aligned to social protection…

- Direct taxes have the potential to be progressive and reinforce redistribution on spending side
- Social security contributions (taxes) can be regressive or progressive – partly depends on benefits
- Countries with high informality (or poverty) try to increase direct taxes through simplified tax regimes
- These can limit the revenue-raising and redistributive potential of direct taxes and sometimes benefit better-off
- Property taxes are equitable and critical for urban development but unpopular

…but indirect taxes often more effective

- Value-added tax has led a revolution in taxation in developing countries
- Indirect taxation not progressive but (thanks to exemptions) might not be regressive
- Where govts offer exemptions on basic goods to offset the costs of taxes, these subsidies often are regressive
  - But they can substitute for social protection in some countries
- Indirect taxes are also used to influence behavior – tobacco, alcohol, sugar, fuel
- They do not create such strong link between tax payer and the state

Tax structures vary by region

VAT accounts for close to 30% of tax revenues in Africa and Latin America

Direct taxes generate 60% of tax revenues in OECD countries

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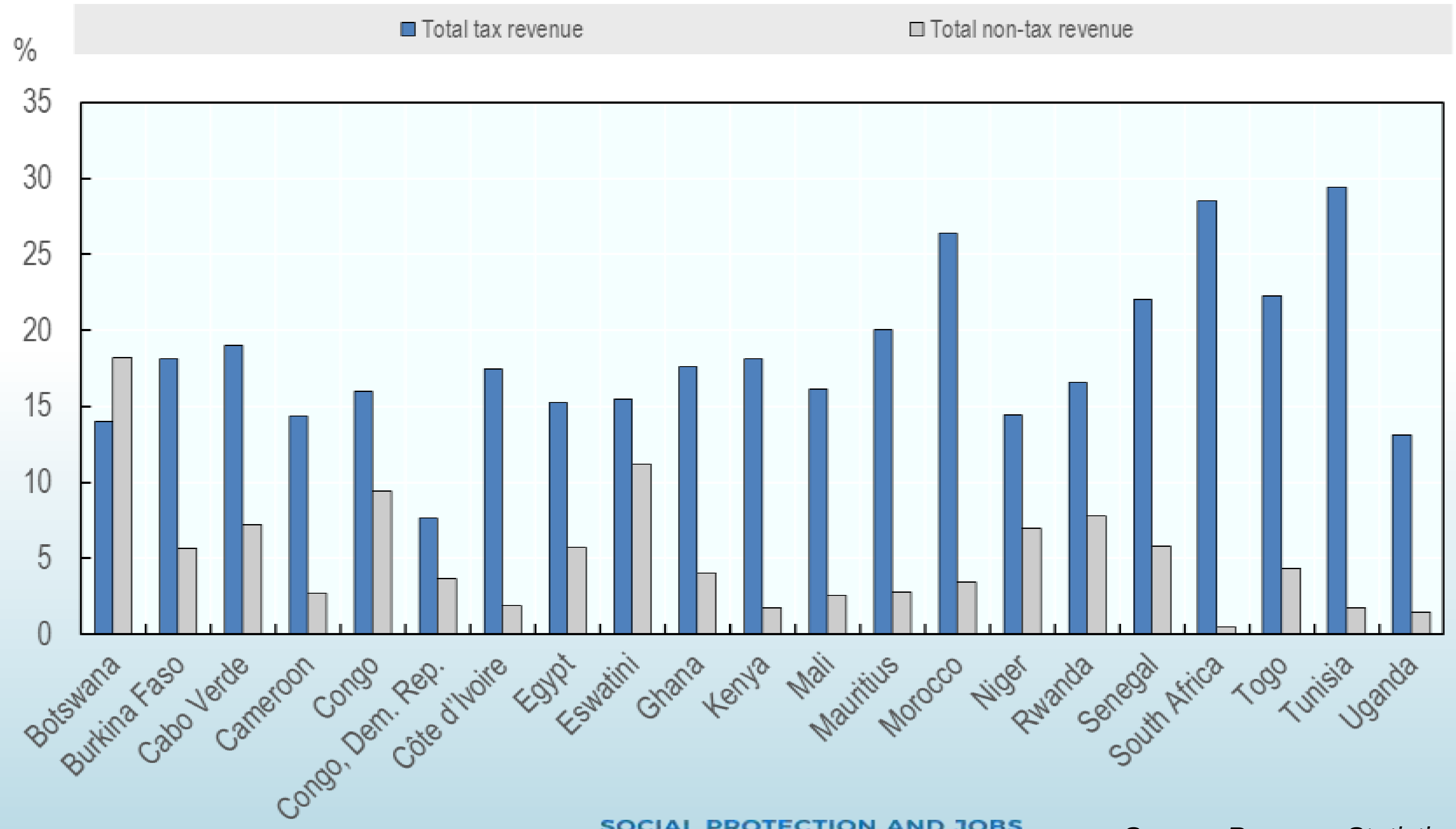
Source: Revenue Statistics in Africa 2018

Grants and resource revenues can be significant…

Non-tax revenues principally include grants (aid), and rents and royalties from natural resources

Africa (21) tax & non-tax revenue as a % of GDP, 2016



Source: Revenue Statistics in Africa 2018

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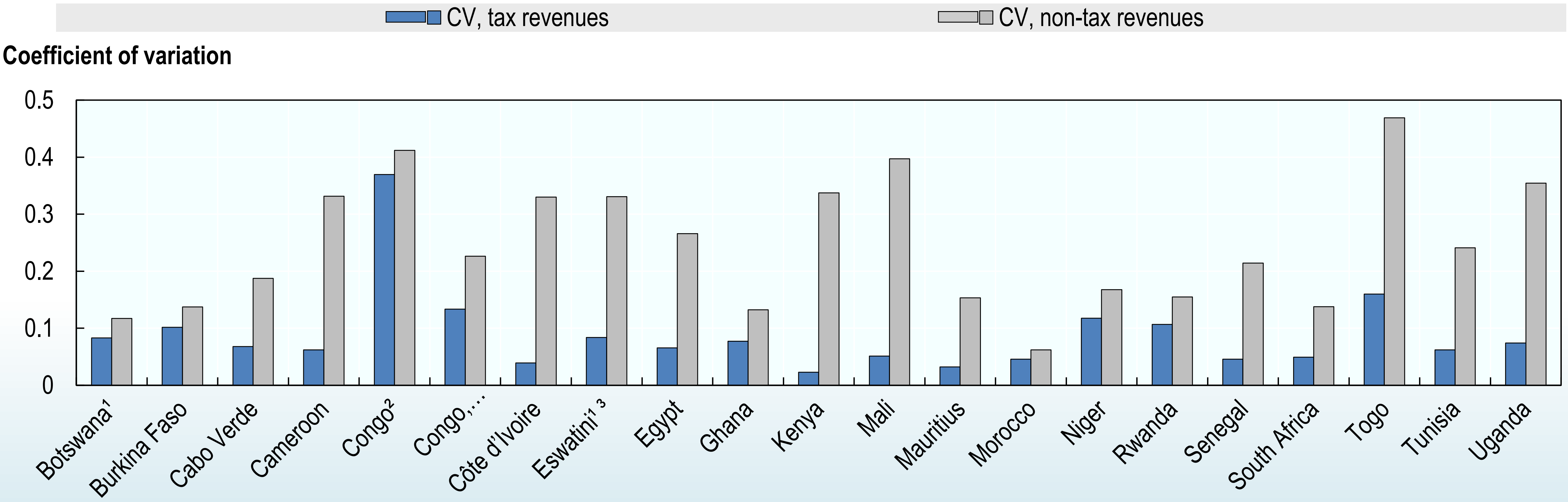
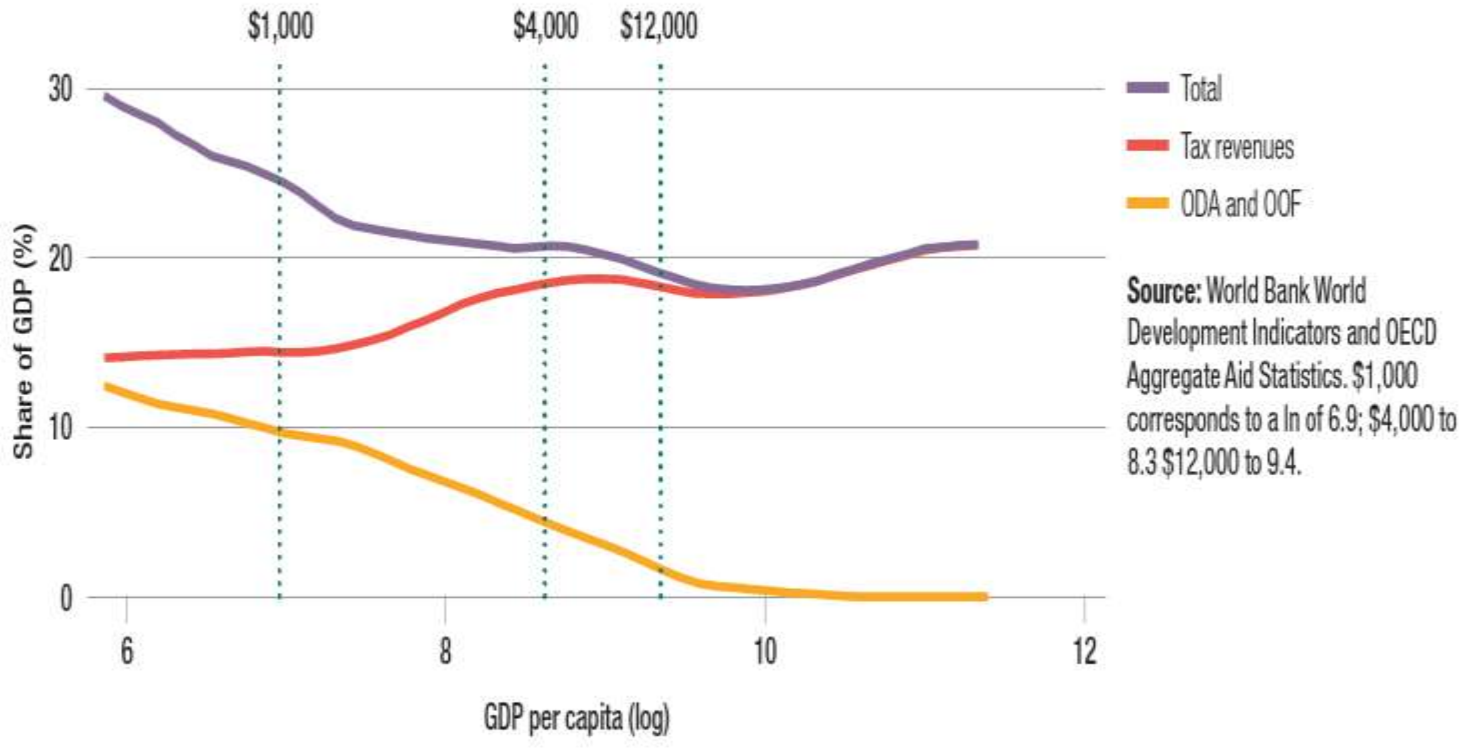
…but also volatile



Source: Revenue Statistics in Africa 2018

Growth in taxes often offset by decline in donor support

ODA, other official flows and tax revenue as a share of GDP by per capita income



Source: Financing the post-2015 Sustainable Development Goals (Kharas, Prizzon and Rogerson, 2014)

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FINANCING STRATEGIES FOR SOCIAL PROTECTION IN THREE EASY STEPS

Step 1: See the whole picture

- Consider social protection in the context of overall public spending

- Look at functional classification
  - How is spending allocated across areas of spending and what are the dynamics?

- Look at economic classification
  - How is spending allocated across types of spending – capital, compensation (salaries), transfers, goods and services, debt servicing?
  - How much spending is discretionary?

- Look at public finances as a whole
  - What is the debt situation? What is the fiscal balance?

Step 2: Find all social protection spending

- Mapping social protection system and monitoring spending dynamics is critical (but can be tricky – especially at local level)
- Social protection evolves over time; fragmentation of implementation and budget responsibility often follows
- Follow spending trends five years back and (if you can) look three years forward
- For contributory schemes look further ahead – know your liability
- What are the cost drivers within a programme? Do they have different dynamics?
- Think about social protection spending as proportion of revenues rather than GDP
- Understand who benefits from social protection spending

Step 3: Understand the financing

- What are the sources of revenue for social protection and what are their dynamics?
  - Tax revenues, non-tax revenues, social security contributions…
- As with expenditure, look at historic trends (level and structure) and look ahead
  - Medium-term revenue frameworks becoming more popular
- Sometimes what looks like a contributory programme, isn't:
  - Governments often subsidise an 'insolvent' system
  - Civil service schemes are often non-contributory
- And understand who is paying for social protection…

FISCAL INCIDENCE ANALYSIS

Looking at both sides of the coin

- We know that (usually)
  - Social protection is likely to reduce poverty and inequality
  - Same with in-kind social benefits: health, education, basic services
  - Subsidies might have mixed impact

- But when we consider how these benefits are financed…
  - Taxes can be regressive or progressive
  - Social security contributions are often payable at a lower wage than income tax
  - Any tax payment reduces consumption

- Fiscal incidence analysis allows us to see both sides of the fiscal coin

What is fiscal incidence analysis?

- Fiscal incidence analysis shows who pays taxes and who receives benefits (cash & in-kind) along income distribution

- Using household survey data, it tracks receipt of social spending (social protection, health, education and basic services) and applies tax rates to income and expenditure

- It then matches results with administrative data to check accuracy

- Data aggregated to show the overall impact of taxes and transfers on poverty and inequality

- Results show ‘net social protection’: what individuals at different income levels get from the fiscal system vs what they put in…

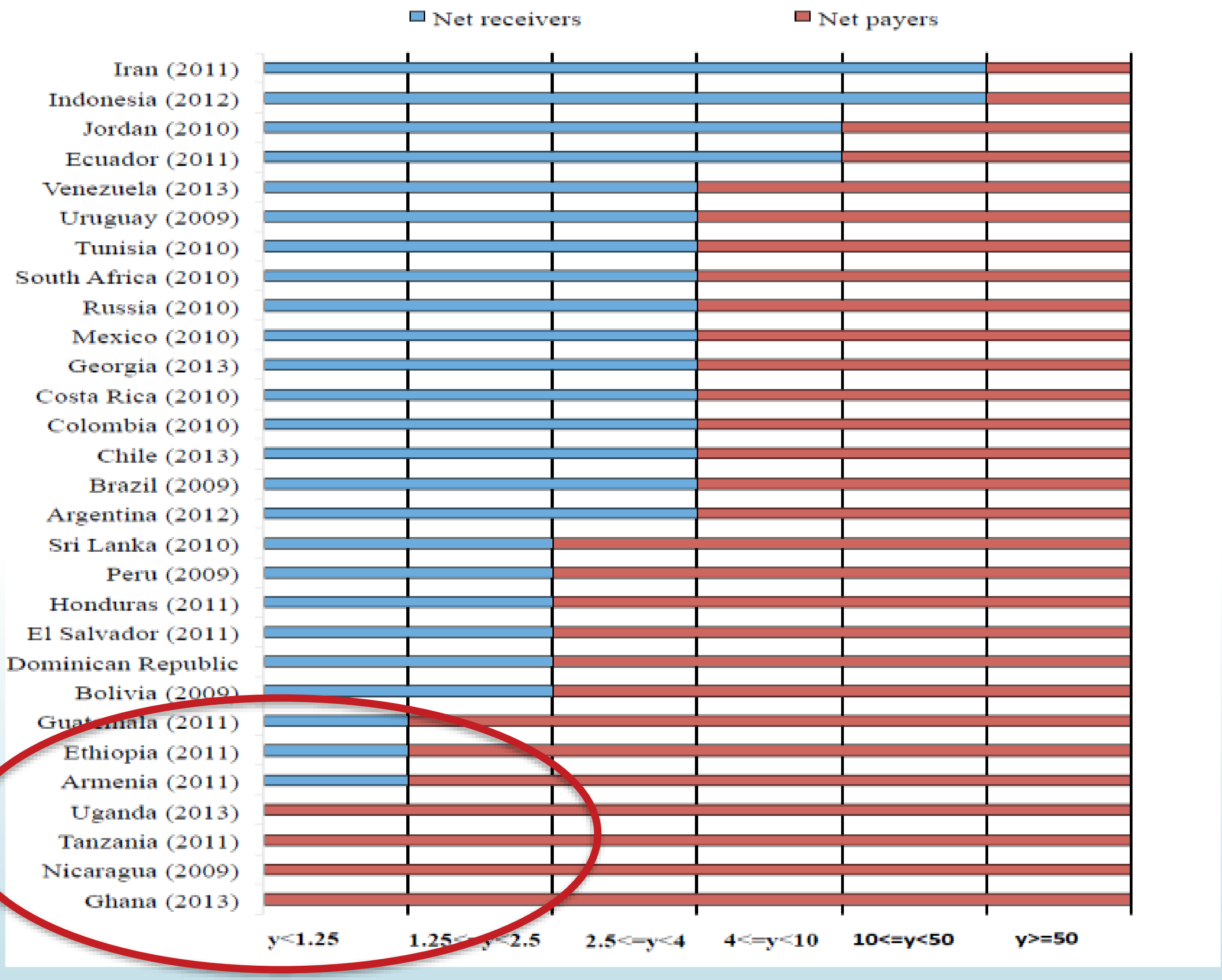
Commitment to Equity Initiative (CEQ)

- CEQ has carried out fiscal incidence analysis in 55 (mostly developing) economies; 21 studies ongoing
- A critical mechanism for the assessing the overall effectiveness of the fiscal system at different income levels…
- …as well as its impact on poverty and inequality overall
- There are limitations
  - They are static accounting models rather than dynamic
  - Certain taxes are excluded (notably corporate income tax)
  - Methodology technically demanding – hard to update often
  - Not all social protection programmes captured in household surveys
  - Doesn't capture inter-generational / regional redistribution

What does CEQ tell us?

- Methodology provides highly detailed, country-specific analysis that should be read with care but certain trends visible across developing countries:
  - Overall impact of taxes and transfers is to reduce inequality but can often increase poverty
  - In-kind transfers (health and education) tend to have greater impact than cash transfers on poverty and inequality
  - In poorer countries, the poor tend to be net payers (in cash terms) due to low value/coverage of benefits and reliance on indirect taxes

Net social protection – givers & takers



In lowest-income countries, everyone is a net payer

Source: Fiscal policy, income redistribution and poverty reduction in low and middle-income countries (Lustig, 2017)

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QUICK CASE STUDIES – KYRGYZSTAN AND ETHIOPIA

Ethiopia’s double challenge

- Ethiopia’s social protection strategy (i) identifies the need to scale up social protection and (ii) targets self-reliance in social protection

- Analysis showed that it would be extremely difficult to finance social protection purely from domestic revenues due to low growth in tax revenues as % of GDP

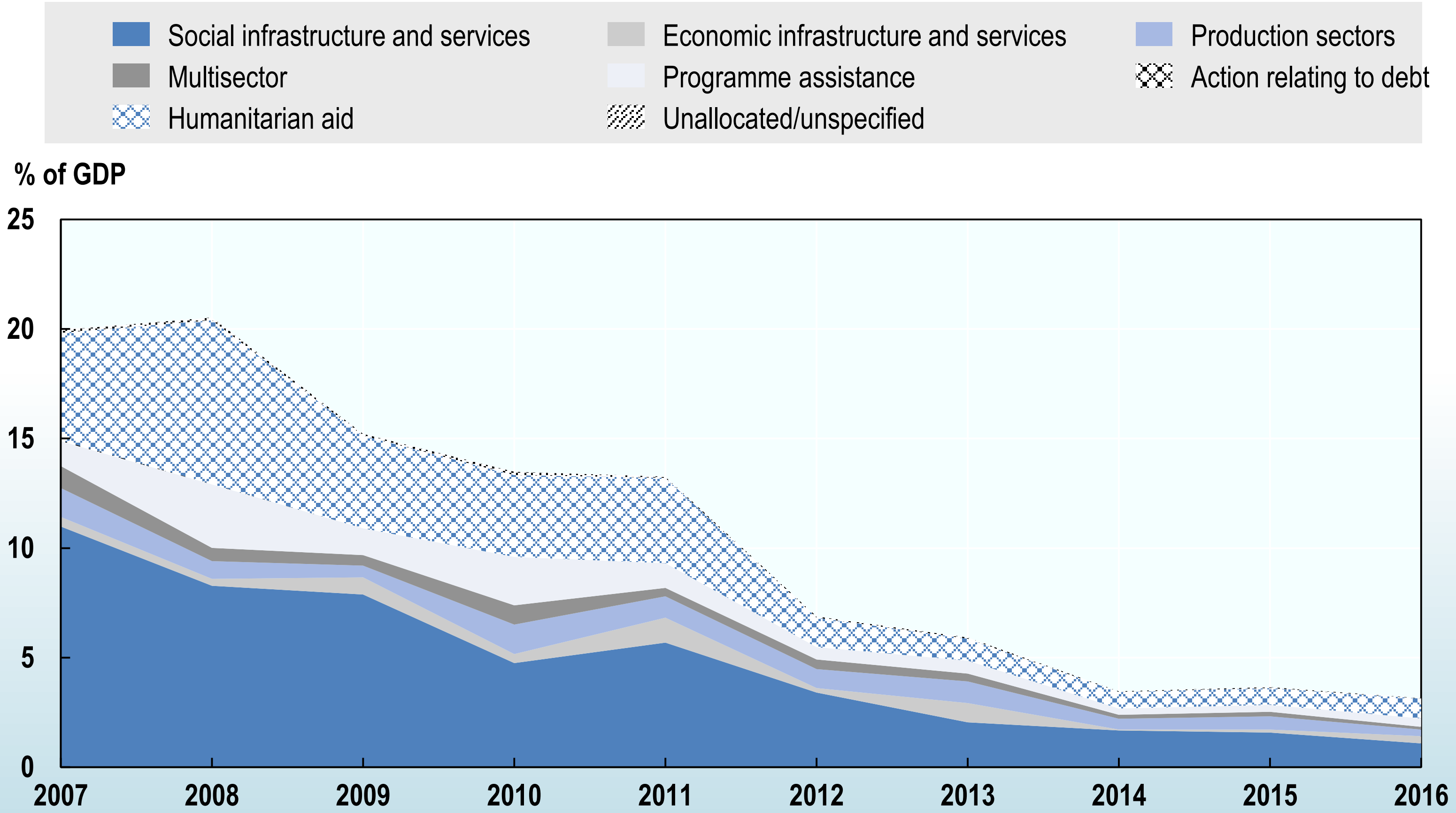
- Humanitarian relief has been very well funded (albeit with some variation) relative to the Productive Social Safety Net Programme, whose spending has declined in real terms

- Clear potential to shift from humanitarian relief to developmental spending but politically not easy

- Looking at social protection spending in absolute terms rather than as percentage of GDP makes the financing situation more positive

A dramatic decline in aid as % of GDP

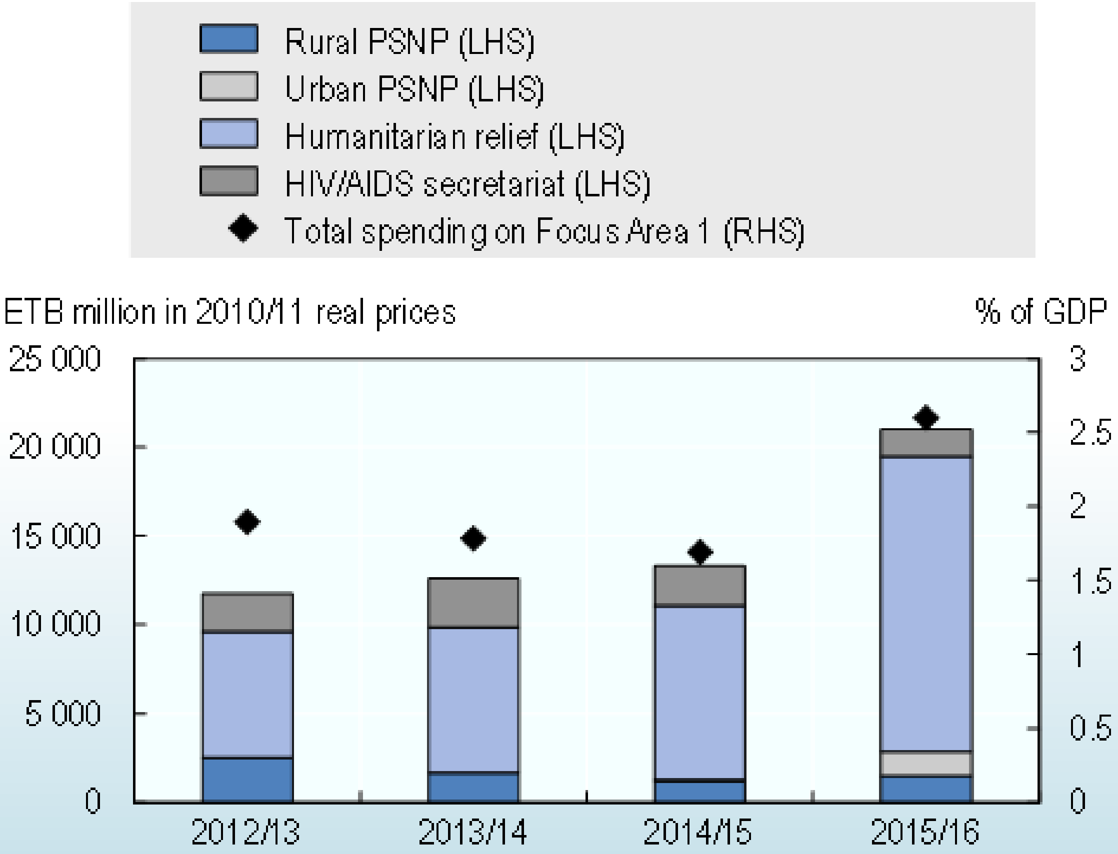
Official development assistance to Ethiopia, % of GDP, 2006-16



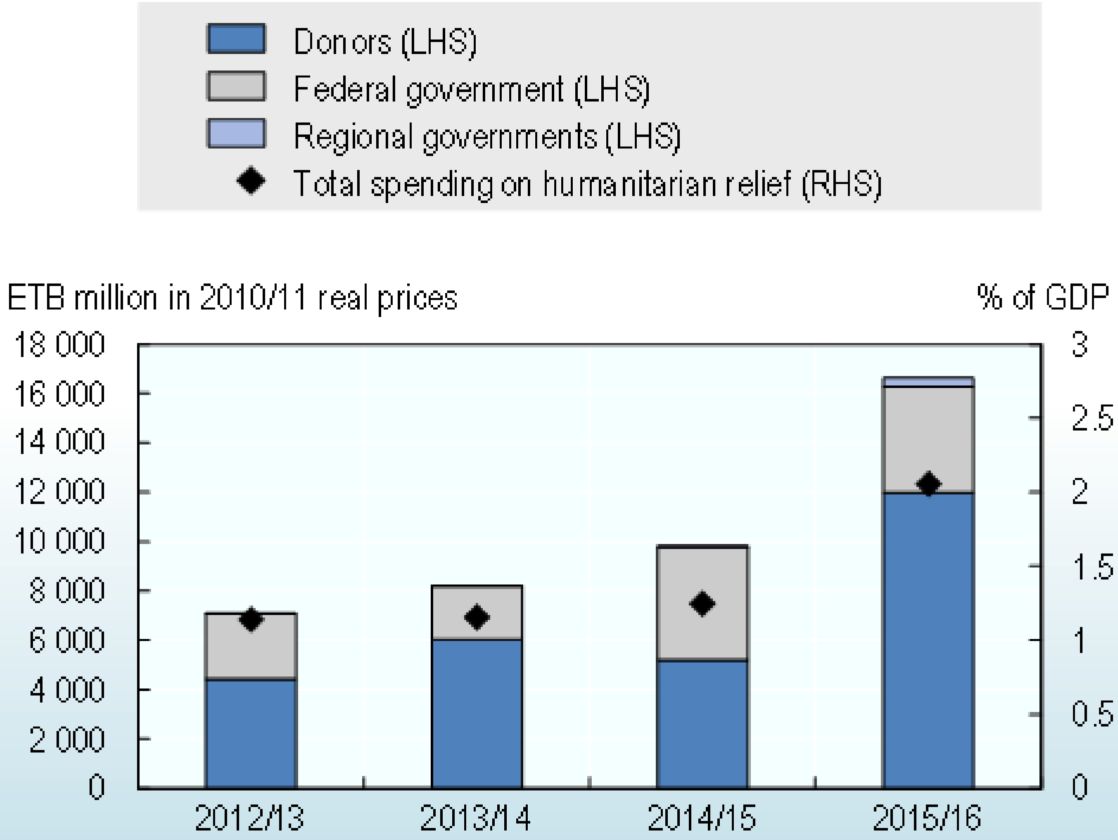
Source: Financing social protection in Ethiopia – A long-term perspective (OECD, 2019)

Safety nets vs humanitarian relief

A. Total spending on Focus Area 1



B. Spending on emergency assistance by source



Source: Financing social protection in Ethiopia – A long-term perspective (OECD, 2019)

Reprioritisation (or not) in Kyrgyzstan

- A high proportion of public spending in Kyrgyzstan finances social protection
  - Legacy of Soviet system and key for poverty alleviation

- Spending on contributory benefits through the Social Fund equivalent to 8% of GDP but is heavily subsidised by public revenues

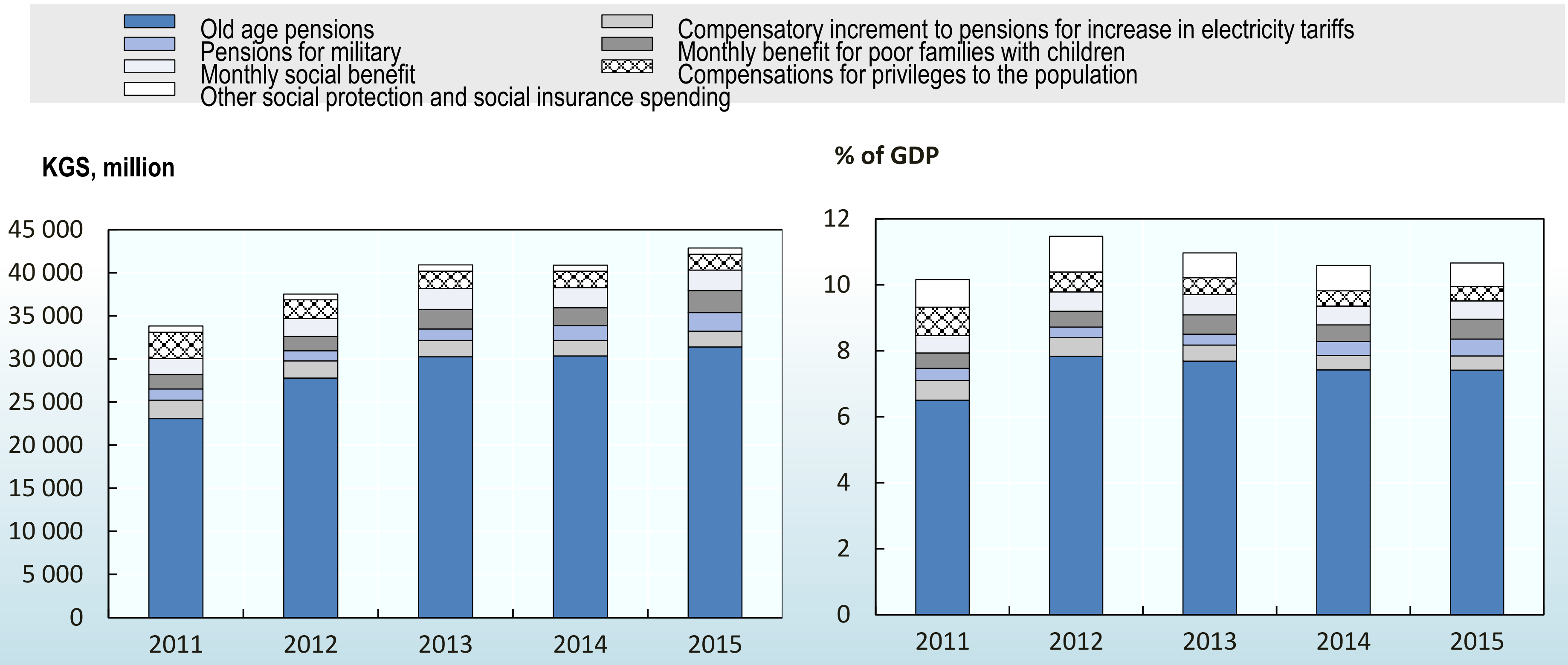
- Spending on social assistance very low (1.2% of GDP) while poverty remains high, especially among children

- Government's plans to introduce a universal child benefit deemed unaffordable

- Could the contributory system meet the financing needs of a new benefit?
  - In theory, yes; in practice, no

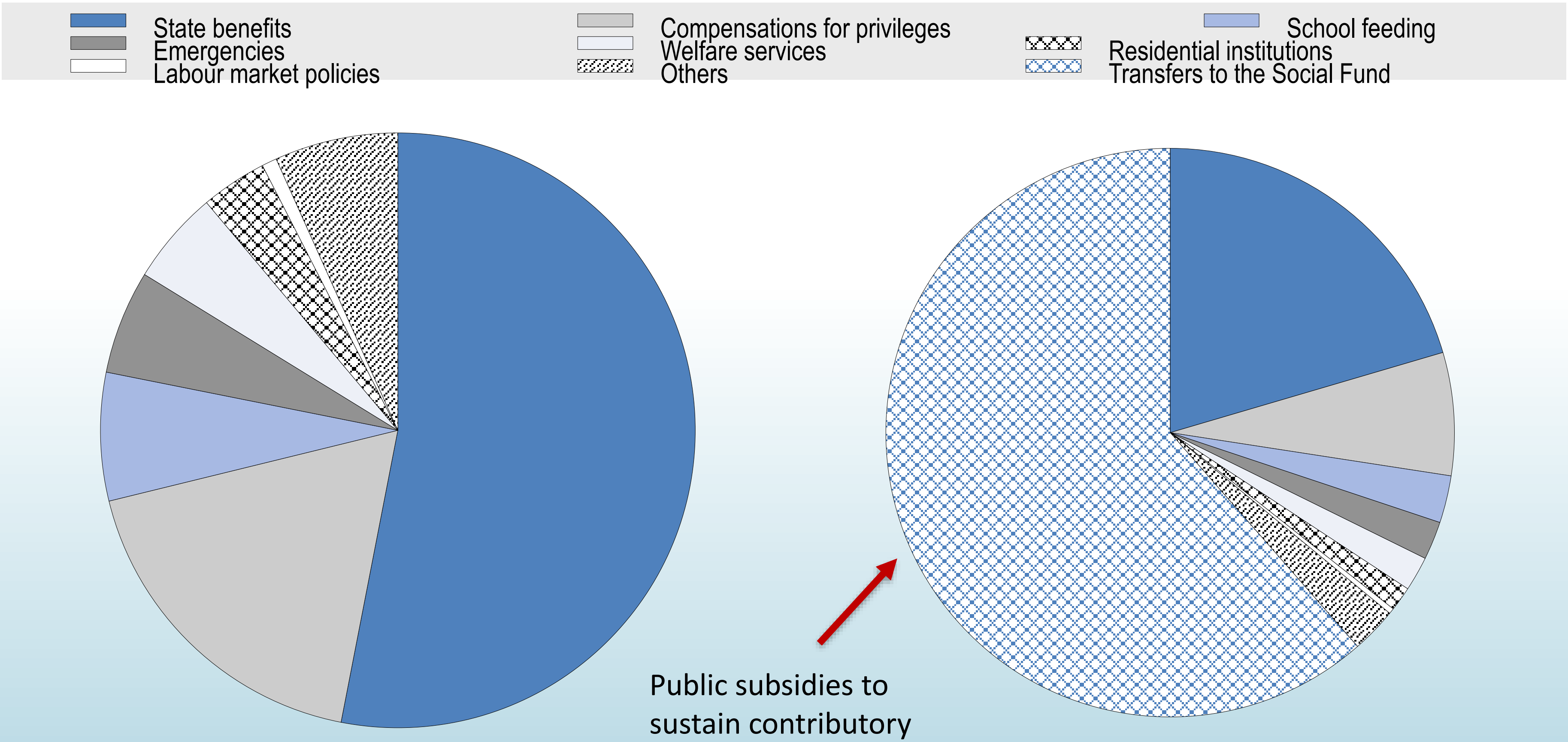
Social protection spending in Kyrgyzstan

Total social protection expenditure, 2011-2015



A contributory system?

Social assistance spending in Kyrgyzstan, 2015
Excluding and including transfers to the Social Fund



Public subsidies to sustain contributory system far exceed social assistance spending

FINAL THOUGHTS

10 Golden rules

1. Affordability varies by country and over time within a country
2. Everything is a priority
3. Reprioritise – look for money from within the social protection budget
4. Take a long-term, gradualist approach when introducing or scaling up a programme
5. Don’t wish away revenues from indirect taxes – tax always battles efficiency versus equity
6. Eliminating subsidies can free up revenues but (very often) creates problems
7. Keep your contributory schemes contributory – even for the military!
8. Make sure social protection experts are in the room when taxes are discussed…
9. …and make sure tax experts are in the room when social protection financing is discussed
10. Don’t tell a tax economist about tax or a Minister of Finance about fiscal space

THANK YOU!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Social Protection System
Review of Kyrgyzstan
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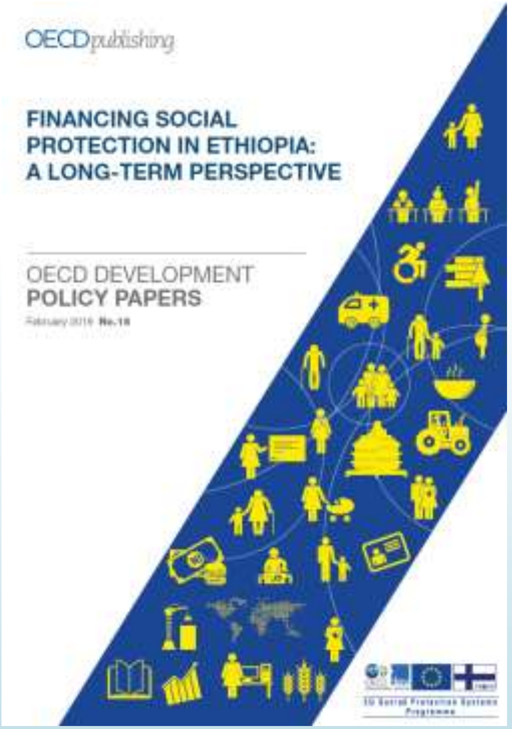
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