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Delivering Social Protection for All

International Labour Organization (ILO)

October 2016

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Delivering Social Protection for All
International Labour Organization (ILO)

Addis commitments and links to the 2030 Agenda:

The Addis Agenda commits to establish a New Social Compact to deliver social protection and essential public services for all. These two components require dedicated funding. Funding for essential public services (including health, education, water and sanitation as well as housing) should not compromise funding for social protection (including transfers in cash and in kind) or vice versa. The distinction between and equal importance of the two components is clarified in Section 2.1.

These commitments expressed in the Agenda are reflected in Sustainable Development Goals targets 1.3, 10.4 and 8.b.

Social protection includes adequate transfers in cash and in kind for all contingencies occurring across the life cycle: transfers for children; benefits/support for people of working age in case of maternity, disability, work injury or for those without jobs; and pensions for all older persons. Protection can be funded through social insurance mechanisms or tax revenues and provided in the form of pensions, social assistance services, public works programs and other schemes guaranteeing basic income security. Accordingly, the Agenda commits to:

"*[…] provide fiscally sustainable and nationally appropriate social protection systems and measures for all, including floors, with a focus on those furthest below the poverty line and the vulnerable, persons with disabilities, indigenous persons, children, youth and older persons*" [Par. 12].

Reinforcing this commitment, the SDGs set the following target (Target 1.3):

"*Implement nationally appropriate social protection systems and measures for all, including floors, and by 2030 achieve substantial coverage of the poor and the vulnerable*".

Data

Monitoring delivery on the commitments on social protection requires tracking funding to national sustainable development strategies that include nationally appropriate social protection systems/floors. The required monitoring comprises two categories:

- **Monitoring the commitments on social protection <u>in national budgets:</u>** National data already collected and classified by function in the framework of the System of National Accounts and Government Finance Statistics for general government spending; social compact expenditures to be included national sustainable development strategies. In as much as possible, track spending that explicitly addresses geographic disparities and inequality among different population groups as well as international benchmarks.
- **Monitoring the commitments on social protection <u>in development aid</u>**: This can be done through the existing OECD DAC CRS codes, selecting those appropriate within codes 16010 (Social/Welfare Services).

Table 1 shows data on general government expenditure for social protection as a percentage of GDP, as prescribed under SDG indicator 8.b.1. Figures range from approximately 3 percent in Sub-Saharan Africa to approximately 18 percent in Western Europe. However, only a share of this expenditure falls on the taxpayer, the largest share being financed by employers' and workers' contributions. Globally, employers contribute 14 percent and workers 7 percent of covered earnings.

Table 1: Government Expenditure for Social Protection (% of GDP)	
North Africa	5.9
Sub-saharan Africa	2.7
Asia and the Pacific	4.6
Middle East	3.4
Western Europe	18.1
Central and Eastern Europe	13.7
Latin America and the Caribbean	5.8
North America	11.0
World	9.9

The role of contributions in financing public social spending is better described by Figure 1, in which public social spending in each country is contrasted with contributions.

Policy Updates

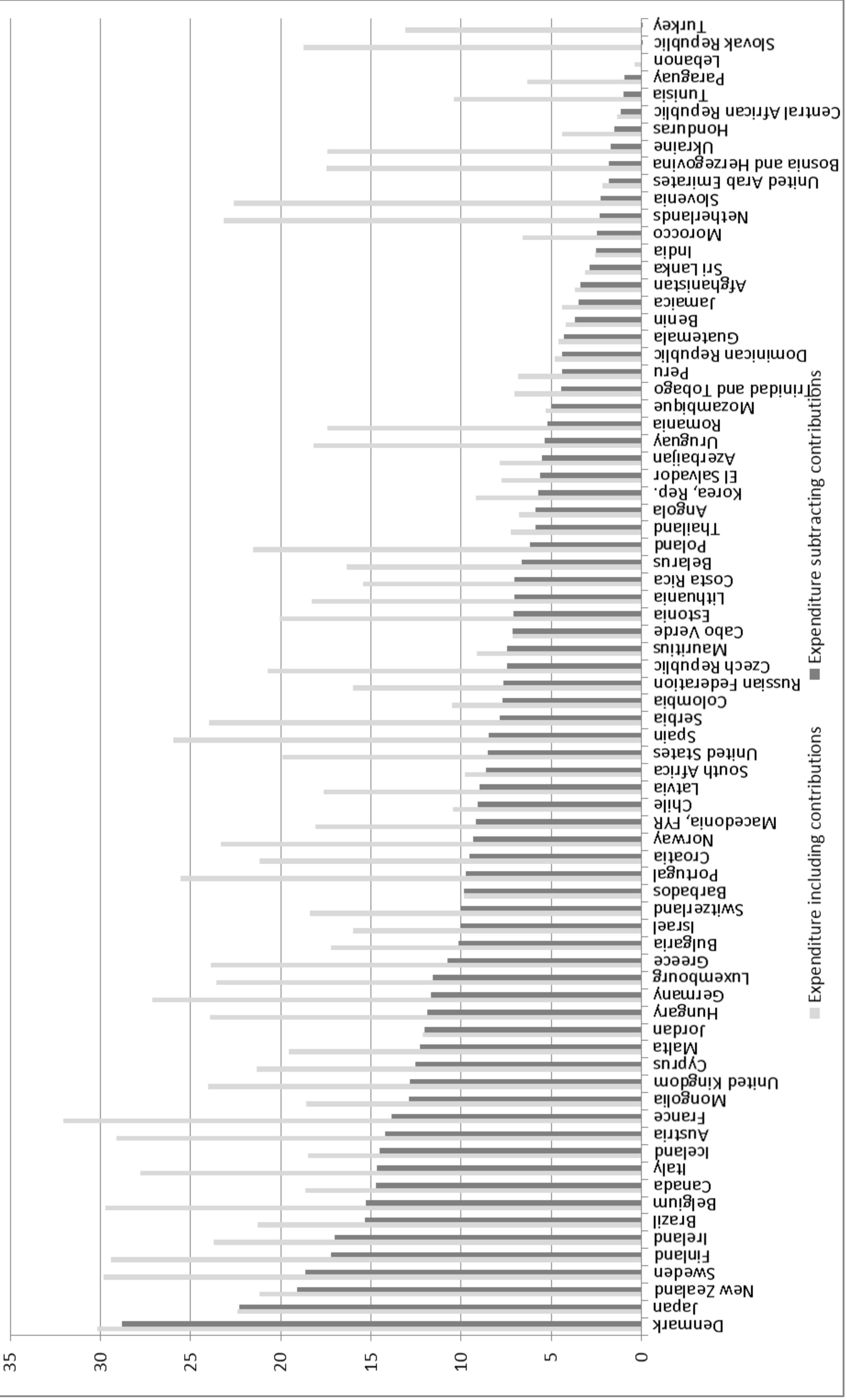
The effort to "Deliver as One" on Social Protection Floors at country-level and through regional United Nations Development Group Teams has gathered momentum, acting on the joint call by the UNDG Chair Helen Clark and ILO Director-General Guy Ryder to create One-UN Social Protection Floors country teams to implement Recommendation 202 on Social Protection Floors. Joint work at country and regional levels is underway in the Asia-Pacific region and Eastern and Southern Africa and will be developed during 2016-17 in Europe and Central Asia and Arab States.

Furthermore, at this year's UN General Assembly, world leaders launched the Global Partnership for Universal Social Protection to support the extension of universal social protection in all countries. Heads of state, the World Bank Group, the International Labour Organization and other international Agencies convened on Wednesday 21 September 2016 to inaugurate the Partnership highlighting the feasibility of universal social protection in every country, as proven by 23 country cases where it has already been achieved.

Country Case Studies

(see Annexes)

Figure 1: Expenditure in Social Security subtracting Contributions as % of GDP



Financing Social Protection through Financial Transaction Taxes

International Labour Office

Social Protection in Action:
Building Social Protection Floors

August 2016

Brazil

Brazil offers an excellent example of how flexibly financial transactions taxes (FTTs) can be used to generate revenues for public provisioning of social services and at the same time to mitigate financial instability arising from short-term capital flows.

Financial Transaction Tax (FTT) is a small tax levied on various types of financial instruments such as shares, bonds, foreign currency transactions, derivatives, and bank debits and credits. The FFTs are implemented in at least 40 developed and developing countries, and 10 European Union countries are expected to adopt a FTT in January 2017. The existing rates vary from a maximum of 2 per cent to as low as 0.00001 per cent.

FTTs have a dual goal of raising revenues while discouraging the type of short-term financial speculation that has little social value but poses high risks to the economy. One estimate shows that FTTs can generate $2.9 - $14.5 billion in all developing countries combined depending on their design (coverage or base and rate) and the size of their financial sector.

FTTs are easy to administer by existing authorities, with no new institutions required. It can be also highly progressive as it allows resources to be channelled directly from the formal economy to those who need social protection.

Social Protection Floors (SPFs) guarantee access to healthcare for all and income security for children, persons of working-age and older persons.

185 countries have adopted the Social Protection Floors Recommendation, 2012 (no. 202) an approach to achieve universal social protection of the population.

This brief presents a successful country experience and gives a practical example of how SPFs can be implemented.

Main Lessons Learned:

- FTTs in Brazil contributed to the collection of nearly $20 billion additional government revenues per year.
- Earmarking government income generated through FTTs directly linked the allocation of funds to social protection programmes (health care (42 per cent), social insurance (21 per cent), Bolsa Familia cash transfers (21 per cent) and other social services (16 per cent)).
- FTTs assisted Brazil to consolidate health system as the largest proportion of it was earmarked for healthcare programmes.
- The FTTs helped Brazil to expand their social protection services and contributed to the reduction in inequality. The Gini coefficient fell by 5.2 points and the percentage of households living below the poverty line halved between the early 1990s and 2008.
- FTTs serve a dual purpose both to encourage certain types of market behaviour (such as longer term investments) and as a revenue raising mechanism.
- Contrary to what is often communicated, there is no evidence of adverse impacts of the FTTs on the financial markets.

FTTs in Brazil

Brazil introduced a bank debit tax first in 1993, but it was short-lived. The longest lasting bank debit tax – Contribuicao provisoria sobre movimentacao ou transmissao de valores e de creditos e direitos de natureza financiera (CPMF)1 – was put in place in 1997 at an initial rate of 0.20 per cent. The rate increased gradually starting in 1999 (0.22 per cent) to 0.38 per cent in 2002. Revenues raised from the CPMF was originally earmarked to finance healthcare programmes (0.2 per cent), to combat poverty (0.1 per cent) and for social assistance (0.08 per cent). The CPMF collected nearly $20 billion per year.

The CPMF was discontinued by the Senate in 2008 after the Supreme Court ruled that earmarking of revenue from such taxes was unconstitutional. This was replaced by a higher rate for financial firms (the Social Contribution on New Corporate Profits), of 15 per cent. But it was repealed in 2013.

According to an IMF report, the CPMF raised about three times the amount raised by the corporate income tax (CIT) on financial companies.1 As can be seen from Table 1, the bank debit tax or CPMF has been a significant source of tax revenue accounting for 7.4 per cent of total tax in 2001.

Table 1: Gross revenues from bank debit tax

Year	Tax rate	Gross revenue	
		% of GDP	% of tax revenue
1994	0.25	1.06	3.6
1997	0.20	0.80	2.8
1998	0.20	0.90	3.0
1999	0.22	0.83	2.9
2000	0.34	1.33	4.8
2001	0.36	1.45	7.4
2002	0.38	NA	6.1
2003	0.38	1.48	NA

A second component of FTTs, the financial operations tax (IOF), introduced in 1999 subjected capital inflows for portfolio investments and investments in local assets to a 2 per cent tax to be paid at the point of the settlement date of the Brazilian Reals. That is, the tax is paid when foreign currency is converted into Brazilian Reals.

According to the government, the IOF tax is designed to offset the impact of short-term capital inflows on Real. Thus, the rate was raised subsequently to slow the appreciation of the Brazilian currency and to prevent speculation in the Brazilian stock and capital markets when the US pursued expansionary monetary policy in response to the 2008-2009 global financial crisis.

The government increased the IOF rate in 2008 on several financial transactions involving foreign exchange, loans and insurance to 0.38 per cent. Since 2009, the IOF has been levied at the rate of 5.38 per cent on foreign loans, where the average payment term of the loan is lower than 90 days. For loans with an average payment term higher than 90 days, the IOF rate is now 0.38 per cent. Additionally, increases in the IOF rate compensated the loss of tax revenue caused by the abolition of the CPMF in 2008.

In June 2015, Brazil slashed the IOF, from 6 per cent to zero to prevent sharp depreciation of Real against the dollar with the market normalizing and upward adjustment of the US interest rate. But this will have significant impact on government's tax revenue, especially when the economy has slowed down.

Therefore, in December 2015, Brazil's Congress approved the 2016 Budget which calls for the creation of a tax over financial transactions (CPMF tax). According to the Finance Minister of Brazil, Joaquim Levy, if the CPMF was not approved, certain important programmes such as unemployment benefits and workers' protection would be at risk.

FTTs and social protection

As the CPMF was designed mainly to finance social protection expenditure, the mechanism was classified as a "social contribution". During the period in which the CPMF was in place, 42 per cent of the revenue collected was used for the public unified health system, 21 per cent for social insurance, 21 per cent for Bolsa Família (conditional cash transfers) and 16 per cent for other social purposes. By 2007, total revenue from the CPMF amounted to 1.4 per cent of GDP, enough to cover the total cost of Bolsa Família and other non-contributory social protection programmes. This represents a significant example of how other developing countries can raise their own revenue to help finance public services. The Gini coefficient fell by 5.2 points and the percentage of households living below the poverty line halved between the early 1990s and 2008 when notable legislative and programmatic changes were made in the economic and social policy sphere, including increasing the minimum wage and public expenditure on health, education and other social services.

Assessment

One estimate shows that Brazil could potentially raise $227million a year from FTTs. Brazil also successfully earmarked revenue for use by local governments to fund health programmes. CPMF revenues rose from approximately 0.8 per cent in 1997-99 to 1.3 per cent of GDP in 2000, and from 2.8 per cent in 1997 to 7.4 per cent of total tax revenues (Table 1). Thus, there seems to be very little leakage or avoidance. From the experiences of other countries it seems that the Brazilian success is likely due to three factors. First, the latest CPMF rate was not excessively high. Second, the Brazilian banking system is relatively sophisticated and widely used for payments. Third, the CPMF was levied on bank debits only, rather than on both debits and credits. This highlights how the implementation details affect success, and in particular the importance of setting an appropriate rate.

There is no evidence of adverse impacts of the CPMF on the financial market. However, there is consistent evidence that the CPMF altered financial and investment behaviour, especially in the wake of its introduction at the end of January 1997. Between January and February 1997, demand deposits increased by almost 40 per cent as the introduction of the CPMF reduced the opportunity cost of holding funds in non-interest-bearing demand deposits.

With regard to incidence the evidence is mixed. The bank debit tax was progressive in so far as it fell on those with a bank account, which are a minority in the wealthiest group of the population. One study found that the incidence of the tax was approximately proportional over the entire income distribution, making the tax neither progressive nor regressive. Another study, using household consumption data and the incidence of the FTT through the price system, found that it fell proportionately more on lower income families.

Concluding

Brazil represents an important example of a FTT regime in a developing country, especially in those with a relatively large financial sector. Between 2000 and 2005 the CPMF accounted for more than 8 per cent of total expenditure on social protection, which shows just how important it was in financing social protection. In particular, revenue raised through CPMF assisted Brazil to consolidate health system as the largest proportion of it was earmarked for healthcare programmes. During the early 2000s, Brazil collected about 37 per cent of GDP in taxes and spent 8.4 per cent of that on health. Thus, government expenditure on healthcare represented 3.4 per cent of GDP.

FTTs serve a dual purpose both to encourage certain types of market behaviour (such as longer term investments) and as a revenue raising mechanism. However, Brazil's on and off episodes with FTTs display the resistance that such taxes can face from vested interests, especially in the powerful financial sector.

There are some concerns that FTTs may harm the poor, especially those depending on remittance income from abroad. But, a group of international finance experts hold the view that it is highly unlikely that the cost of a small tax of say 0.005 per cent on such transactions, which would amount to a tax of just 5 cents on a $1,000 transfer would be passed on to the retail customer. Furthermore, the poor are highly unlikely to be engaging in the high-speed speculative trading activities that are the target of these taxes. Moreover, remittances can be exempt from FFTs if need be.

FTTs are easier to administer as technological advancements have made such tax collection much easier. A number of developing countries have already implemented some form of financial transactions and the IMF believes that such taxes can generate substantial revenues.

Taxing financial transactions is one of the many alternatives that countries have to expand fiscal space for social protection. Governments normally use a mix of taxes and social security contributions to fund social protection, combined with other options explained in the paper "Fiscal Space for Social Protection: Options to Expand Social Investments in 187 Countries".

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Financing Social Protection through Debt Restructuring

International Labour Office

Ecuador

Social Protection in Action:
Building Social Protection Floors

Ecuador offers an excellent recent example of how sovereign debt work can be used to create fiscal space for social development expenditure.

The idea of swapping debt for development has been around since the 1980s as a way out from the Latin American debt crisis. During the 1998-2008 decade, 18 debt swaps in 14 countries converted about $608.8 million of debt into support for local development.

The Highly Indebted Poor Countries (HIPC) Initiative, launched in 1996 by the IMF and the World Bank, helped eligible countries reduce their debt service payment by about 1.8 per cent of GDP between 2001 and 2014. Linking debt relief to poverty reduction and social policies allowed these countries to increase their expenditures on health, education, and other social services. On average, such spending is now about five times the amount of debt-service payments.

But only low income countries could access HIPC. Other countries had to resort to debt restructuring. In recent years, more than 60 countries have successfully re-negotiated and structured debt, directing debt servicing savings to development, including social programs.

It is now well accepted that countries can create fiscal space to increase social spending through debt restructuring linked to social programmes

Social Protection Floors (SPFs) guarantee access to healthcare for all and income security for children, persons of working-age and older persons.

185 countries have adopted the Social Protection Floors Recommendation, 2012 (no. 202) an approach to achieve universal social protection of the population.

This brief presents a successful country experience and gives a practical example of how SPFs can be implemented.

Main Lessons Learned:

- Ecuador defaulted on its “illegimate” debt and freed-up public resources for expanding healthcare, education and social protection programmes. Social spending more than doubled from 4.8 per cent in 2006 to 10.3 per cent of GDP in 2011.
- The freed-up public resources were also successfully used to help the economy recover from the 2008 financial crisis. GDP growth grew from 0.4 per cent in 2009 to 7.8 per cent in 2011, surpassing the pre-crisis growth rate of 7.2 per cent in 2008.
- Debt restructuring enabled the government through social and human development investments to reduce poverty rates from 37.6 per cent in 2006 to 22.5 per cent in 2014, while the Gini coefficient (measuring inequality) declined from 54 to 47 per cent during 2006-2011.
- Contrary to what critics would expect, Ecuador`s credit reputation did not suffer as their social and human development investments are also regarded an economic success. Ecuador was able to sell $2 billion worth of bonds in 2014 at their first return to the international capital markets.

August 2016

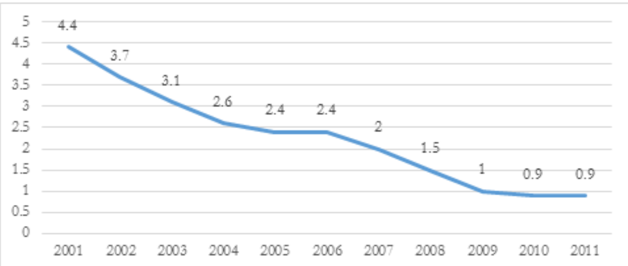
Ecuador's default on "odious" debt expands fiscal space

In 2008, Ecuador held an official audit to assess the legitimacy of its sovereign foreign debt.[1] The government-commissioned, two year-long investigation concluded that some of its foreign debts violated multiple principles of international and domestic law and were therefore deemed "illegitimate". These were mostly private sector debts that had been nationalized by former governments.

While Ecuador respected all of the debt that had contributed to the country's development -- the so-called "legitimate" debt – it wrote down its "illegitimate" debt in November 2008 to 35 cents to the dollar. This meant significant reduction in interest payments as a percentage of GDP (Figure 1). The savings on account of principal and interest would amount to more than $7 billion over the period 2008-2030. The freed-up public resources were used for fiscal stimulus to cushion the impact of the 2008-2009 global financial crisis, and for expanding healthcare, education, social assistance and developing communications infrastructures.

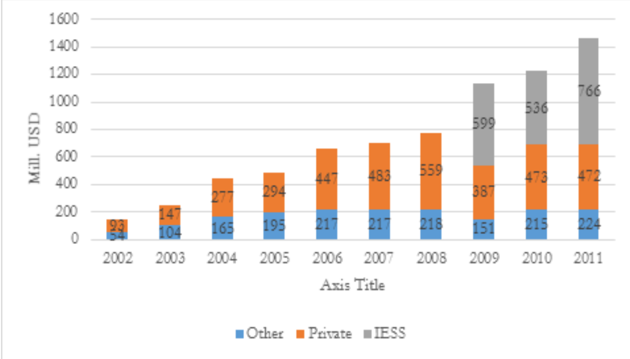
One of the elements of fiscal stimulus was expanded access to housing financing, through *bono de la vivienda* programs and concessional mortgage loans issued through Ecuador's Social Security Institute (IESS). The total housing loans in Ecuador grew by nearly 50% in 2009, and IESS accounted for over half of all housing credit in 2011 (Figure 2). This contributed to a construction boom in early 2010 and helped the economy recover quickly from the recession. The overall GDP growth rate rose from 0.4 in 2009 to 7.8 per cent in 2011 surpassing the pre-crisis rate of 7.2 per cent in 2008 and catching up its 20-year growth trend.

Figure 1: Interest payments (% of GDP) decline



Source: Ray, Rebecca and Sara Kozameh (2012), "Ecuador's Economy Since 2007", Center for Economic and Policy Research, May

Figure 2: Housing credit by source (in millions of USD) expands

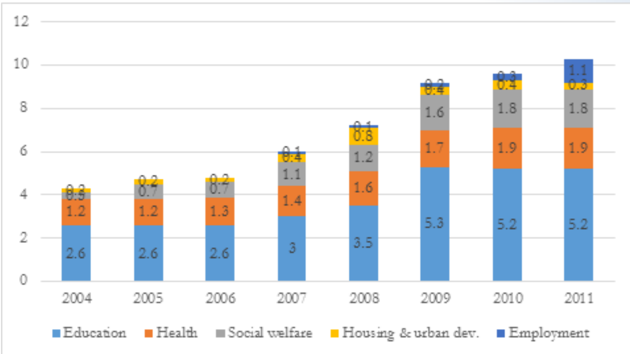


Source: Ray, Rebecca and Sara Kozameh (2012), op. cit.
Note: IESS = Loans issued through the Social Security Institute

Higher social spending

Public resources freed up in Ecuador through the debt write-down were invested in social and human development. Total social spending more than doubled from 4.8 per cent of GDP in 2006 to 10.3 per cent in 2011 (Figure 3). Government spending on education doubled – from 2.6 to 5.2 per cent of GDP during the same period. Social welfare spending which included housing assistance programmes for low-income families and the cash transfer *Bono de Desarrollo Humano* (human development bond), also more than doubled – from 0.7 to 1.8 per cent of GDP. This resulted in the expansion of *Bono de Desarrollo Humano's* coverage from 35.5 in 2005 to 44.3 per cent in 2010 – the highest coverage by conditional cash transfer programmes in Latin America and the Caribbean.

Figure 3: Public social spending (Central Government, % of GDP) increases

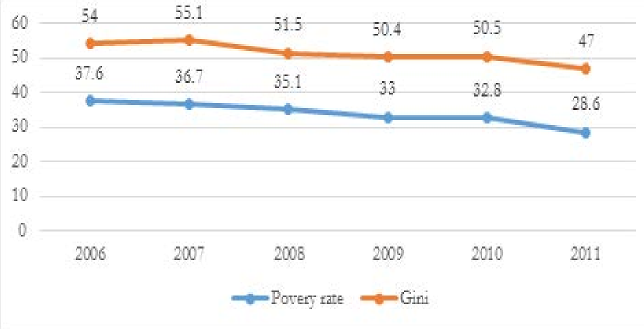


Source: Ray, Rebecca and Sara Kozameh (2012), op. cit

Human development accelerates

The results of increased public social spending on human development made possible by debt restructuring are impressive. For example, the national poverty rate dropped from 37.6 per cent in 2006 to 22.5 per cent in 2014 (Figure 4). This improvement is also reflected in the unemployment rate which fell from 9.1 per cent in the 1st quarter of 2010 to 4.9 per cent in 2012.

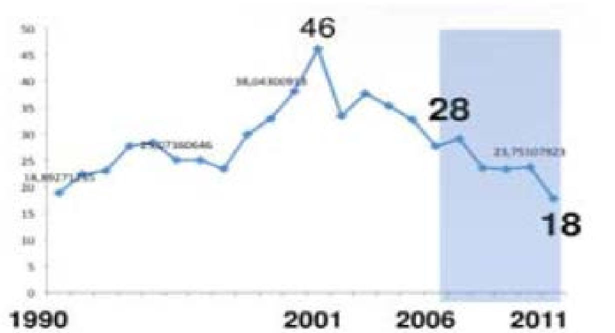
Figure 4: Poverty rate and Gini coefficient decline



Source: Ray, Rebecca and Sara Kozameh (2012), op. cit.

The Gini coefficient, a common measure of inequality, declined from 54 to 47 per cent during 2006-2011 (Figure 4). The improvement in income distribution is also mirrored in the decline of the ratio between incomes of the rich (highest 10 per cent) and the poor (lowest 10 per cent) (Figure 5).

Figure 5: Ratio between rich and poor income shrinks

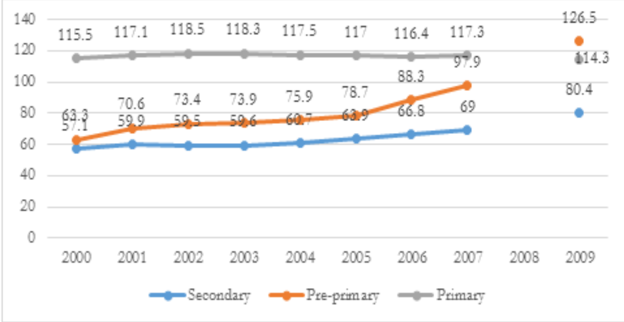


Source: International Policy Research Brief, No. 28, August 2012, Centre for Inclusive Growth

The expansion of the *Bono de Desarrollo Humano* contributed to a sharp increase in the number of children vaccinated from 2.5 million in 2008 to 3.6 million in 2010. Between 2009 and 2015, 2,994,411 children under 5 had preventive medical check-ups.[1] More than 800,000 children received micro-nutrients and its consumption has been monitored by children centres. During this period, 6,571,169 children under 5 with some disease were treated and 3,078,408 prenatal examinations were performed with the provision of micro-nutrients. Thus, infant mortality declined from 20.7 (per 1,000 live births) in 2006 to 17.6 in 2010, and child mortality fell from 26.6 (per 1,000 children under age 5) to 23.0 during the same period. There have also been dramatic increases in pre-primary and secondary school enrolment rates (Figure 6).

By the end of 2015, Ecuador had achieved 20 of the 21 MDGs, some beyond the standard minimum target.

Figure 6: School enrolment ratios (gross) rise



Concluding

Ecuador suffered repeated debt crises after the early 1980s and public external debt remained high (over 66 per cent of GDP) in 2000. "Structural adjustment" packages of liberalization, privatizations and labour market reforms failed to reignite growth on a sustained basis while the country's social and human conditions deteriorated significantly with more than 60 per cent of its population living in poverty in the late 1990s. Ecuador's human development index (HDI) was 0.6 in 1980, which improved only marginally to 0.674 in two decades.

However, Ecuador's socio-economic development since the beginning of the new millennium has been impressive. Ecuador's HDI value for 2014 was 0.732—which put the country in the high human development category. Its social development accelerated since 2009 when it expanded its fiscal space by defaulting its external debts, deemed "illegitimate", to strengthen its social protection and increase social spending. Perhaps this explains why Ecuador's credit reputation was not permanently damaged contrary to the general perception. It was able to sell $2 billion of bonds in June 2014 on its first return to the international capital market. Thus, Ecuador offers lessons for other developing countries as to how successfully restructure external debt for social development. Based on the experience of Ecuador, as well as Norway, a special United Nations Commission of Experts on Reforms of the International Monetary and Financial System came out in support of public debt audits as a mechanism for transparent and fair restructuring of debts. Debt audits are ongoing in several other countries, such as Bolivia, Brazil, Greece, Ireland and the Philippines.

Debt management is one of the eight alternatives that countries have to expand fiscal space for social protection. Governments normally use a mix of taxes and social security contributions to fund social protection, combined with other options explained in the paper "Fiscal Space for Social Protection: Options to Expand Social Investments in 187 Countries".

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Financing Social Protection through Taxation of Natural Resources

International Labour Office

Mongolia

Mongolia is an example of a country that has recently started to take more advantage of its vast natural resources. Mongolia's development has been spurred by its extraction industry revenues. The government has made significant efforts to ensure that the wealth created from its natural resources is shared among the wide population and that resources are directed to social protection programmes such as the Universal Child Money programme.

An abundant natural resource in resource-rich countries can create the base for development and support social and socio-economic spending, technological advancement, FDIs and overall economic growth.

Experiences of Bolivia, Brazil, Chile, Argentina, Colombia, Botswana, Zambia, Indonesia and Malaysia as well as those of developed countries such as Australia, Canada, Norway, Sweden, and the United States, show positive socio-economic effects that natural resource extraction can have.

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This brief presents a successful country experience and gives a practical example of how SPFs can be implemented.

Main Lessons Learned:

- Natural resource rich countries can boost their social protection system through the taxation of natural resources, increasing government revenue and supporting the expansion of social protection expenditures.
- Earmarking government income generated from natural resources directly linked the allocation of funds to social protection programmes and helped redistributing wealth created from natural resources to the wider population.
- Through the taxation of natural resources and the expansion of social protection spending, the government managed to significantly reduce poverty rates.
- Efforts to increase transparency and operational efficiency on all levels of the government support the allocation of funds to social expenditures.
- The establishment of a stabilization fund would further help in balancing volatility in government revenues due to natural resource price fluctuations.

Social Protection in Action:

Building Social Protection Floors

August 2016

The risk of natural resource abundance

Even though some countries have fared well, the impact of natural resource abundance is not always clear and predictable. In some cases, abundant natural resources have been a curse, rather than a blessing, resulting in large-scale corruption, strengthening of authoritarian rules and environmental damages. Exploitations of mineral resources in the Democratic Republic of the Congo and of oil in Nigeria, Angola, and Equatorial Guinea, show a vivid picture of misappropriation of extractive industry revenues. Lopsided growth due to “Dutch disease” can further lead to a crowding out of other sectors and make the national economy less competitive due to currency appreciation, making exports more expensive and less competitive.

When looking at the successful cases, one can observe analogies that will provide hints on what to avoid and on which aspects to emphasis in the set-up of a natural resource extracting economy. Redistributive elements, linking natural resource rents and taxes to social and socio-economic investments and development, the strengthening of tax authorities, increasing transparency and improving governance structures, are common elements observed in countries that have successfully developed with the help of natural resource extractive industries.

Taxing natural resource extraction in Mongolia

The Mongolian economy has been on a successful growth pattern, with an average growth rate of around 8.4 per cent between 2005 and 2015, being one of the fastest growing economics in the world. In parallel, the poverty rate has been on a downward trend from 38.8 per cent in 2010 to 21.6 per cent in 2014.

Mongolia, especially in relation to its population of 2.9 million, is rich in natural resources and the country’s gold and copper reserves are among the largest in the world. The estimated value of total natural resource reserves that have been identified to date is US$ 1.3 trillion. Natural resources include copper, gold, coal, molybdenum, iron ore, uranium, tin, tungsten, silver, zinc and fluorspar.

The Government of Mongolia applies royalty rates of 5 per cent on natural resource extraction. In addition, there is a 10 per cent corporate income tax on profits and surcharges in the form of progressive royalty rates and exploration and production licencing fees.

Over the past decade, natural resource extraction has been booming, and in 2010, the extractive sector accounted for 30 per cent of GDP, 32 per cent of government revenue and 81 per cent of exports, with an employment share of 5 per cent of the total workforce. Government revenue increased significantly since the expansion of natural resource extraction operations.

There have been visible efforts to increase transparency and operational efficiency on all levels of the government. Mongolia joined the Extractive Industries Transparency Initiative, received a full compliance status in 2010 and have reported on a regular basis its revenues.

Natural resource extraction revenues and social protection

Several initiatives have been launched in Mongolia during the last decade, aiming at linking the revenues collected from the natural resource extraction industry to social protection programmes and redistributing wealth created from natural resources to the wide population.

a) The Mongolian Development Fund (MDF)
   In July 2006, the government introduced universal child benefits. In parallel, Windfall Profits Taxes were introduced to capture a higher share of mining profits. All revenues created from natural resource extraction (dividends & 70 per cent of royalties) entered the newly created Mongolian Development Fund (MDF). This was the government’s first attempt to create a sovereign wealth fund. The fund had the purpose of stabilizing unplanned budget deficits; undertook investments aiming at increasing domestic economic capacity; supported small and medium enterprises; and supported children and families through the universal child benefit scheme. The MDF was the Government`s first effort to legislate the link between government resource receipts and cash transfers. In January 2007, the MDF significantly increased the annual benefit amount of the universal Child Money programme, from 36,000MNT (US$ 30.76) to 136,000 MNT to (US$ 116.19) per child.

(b) The Human Development Fund (HDF)

In 2009, following the 2008 elections and after the initial turmoil of the financial crisis that also strongly affected natural resource prices, the MDF was replaced by the Human Development Fund (HDF). The mandate of the Fund, similar to the previous one, was to create and grow sustainable resources for better income distribution among the population. The HDF had the same function as the MDF but on a much larger scale. The legislation did not limit benefits and included health insurance and pensions, housing payments, cash, and medical and education service payment. Cash transfer amount was set at 120,000 MNT (US$ 89.08) per person in 2010. Total cost of the schemes was three times as much as the Child Money Program in 2009. The new schemes under the HDF were generous and came under pressure after revenue income did not meet expenditures. The fund was temporarily replaced by a targeted poverty benefit programme.

Currently the Government is considering the establishment of a sovereign wealth fund, called the Future Heritage Fund. The fund is proposed to be operational as of 2018 and will replace the HDF. Yet the idea is highly controversial and critics are questioning the benefits as it diverts funds from social investments. It will invest resources in international capital markets rather than on people and national development.

Alternatively, a stabilisation fund could help mitigate the risk of market and price volatility and help the government to maintain a higher degree of liquidity during economic downturns and mineral price drops. As a result the government is more likely to be in a position to balance social investments in the long run.

The Economic and Social Stabilization Fund of Chile is a good example of how to maintain liquidity and balance public expenditures. The stabilization fund is a countercyclical tool that aims to smooth government expenditures, to finance fiscal deficits in times of low growth and/or low copper prices and to pay down public debt when necessary. Funds can be withdrawn from the Economic and Social Stabilization Fund at any time in order to fill budget gaps in public expenditure and to pay down public debt.

A high degree of fiscal flexibility is maintained by investing in portfolios with a high level of liquidity and low credit risk and volatility. The fund is invested to 30 per cent in money market instruments, 66.5 per cent in sovereign bonds and 3.5 per cent in inflation-indexed sovereign bonds. The Chilean Economic and Stabilisation fund represents a model for Latin America and could be applied in other countries that face similar market volatilities.

Conclusion

Mongolia presents a case where government revenues generated from taxation of natural resource extracting companies have been directed to social protection programmes. The government was successful to redistribute some of the wealth of the extracting industry.

Taxing natural resource extraction is one of the many alternatives that countries have to expand fiscal space for social protection. Governments normally use a mix of taxes and social security contributions to fund social protection, combined with other options explained in the paper "Fiscal Space for Social Protection: Options to Expand Social Investments in 187 Countries".

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Financing Social Protection through Taxation of Natural Resources

International Labour Office

Zambia

Social Protection in Action:
Building Social Protection Floors

Zambia is an example of how countries with rich natural resources can rely on taxation, specifically on natural resource extracting companies, to improve social protection services and programmes and to help mitigate inequality and to reduce poverty.

Developing countries often struggle to generate government revenues for social protection through taxation and social security contributions. Tax authorities tend to be weak and taxation lack transparency, while a relatively large share of the population is employed in the informal sector, making it difficult and costly to collect social security contribution or tax employees. This limits the means to redistribute income and to develop adequate social protection systems, including floors, to reduce poverty and inequality.

Social Protection Floors (SPFs) guarantee access to healthcare for all and income security for children, persons of working-age and older persons.

185 countries have adopted the Social Protection Floors Recommendation, 2012 (no. 202) an approach to achieve universal social protection of the population.

This brief presents a successful country experience and gives a practical example of how SPFs can be implemented.

Main Lessons Learned:

- Natural resource rich countries can boost their social protection system through the taxation of natural resources, increasing government revenue and supporting the expansion of social protection expenditures.
- Through strengthening tax collection authorities and the revenue collection framework of the government, reduced tax leakage contributed to further increases in government revenues and the creation of fiscal space for social protection measures.
- In 2013, Zambia's extractive revenue was US$ 1.5bn annually and represented 30 per cent of total government revenue.
- With the help of the extractive industry revenues, the government increased the budget for the social cash transfer schemes substantially, from KR 55 million in 2012 to KR 199.2 million in 2014.
- Through the taxation of natural resources and the expansion of social protection spending, the government managed to reduce poverty rates and improve health indicators fare above African standards.

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Natural resource extraction tax in developing countries

Countries that can rely on non-renewable natural resources, have the potential to collect significant amounts of taxes from the sector to support social and socio-economic development. A government may either directly extract natural resources through state-owned enterprise or joint-ventures, or sell the exploitation rights and tax profits, both of which provide revenues for social investments. A number of developing and emerging economies have effectively managed their natural resources through public companies, including Botswana (diamonds), Brazil (oil), Indonesia (oil and gas) and Malaysia (forestry, tin, oil and gas).

Environmental and social externalities, such as the impact on local communities, which, if not adequately addressed, can serve as a subsidy to extracting companies and distort the true cost of exploitation. Natural resources from a property rights perspective are resources that ought to be accrued to the public at large rather than to private citizens. Revenues generated from natural resources should be distributed among society, leaving enough reward for companies to engage in exploitation, while taking into account the true cost of exploitation and equity from a property rights perspective as a whole.

Natural resource taxation in Zambia

Zambia is one of the prominent examples of a country having raised various taxes on mineral resources and thus generated significant government revenues that are among others funding social expenditures. Zambia, with a population of 16.2 million, is the 8th largest producer of copper (2013) and the 9th largest producer of cobalt (2012), with the mining sector accounting to 9 per cent of GDP and 77 per cent (2015) of exports.

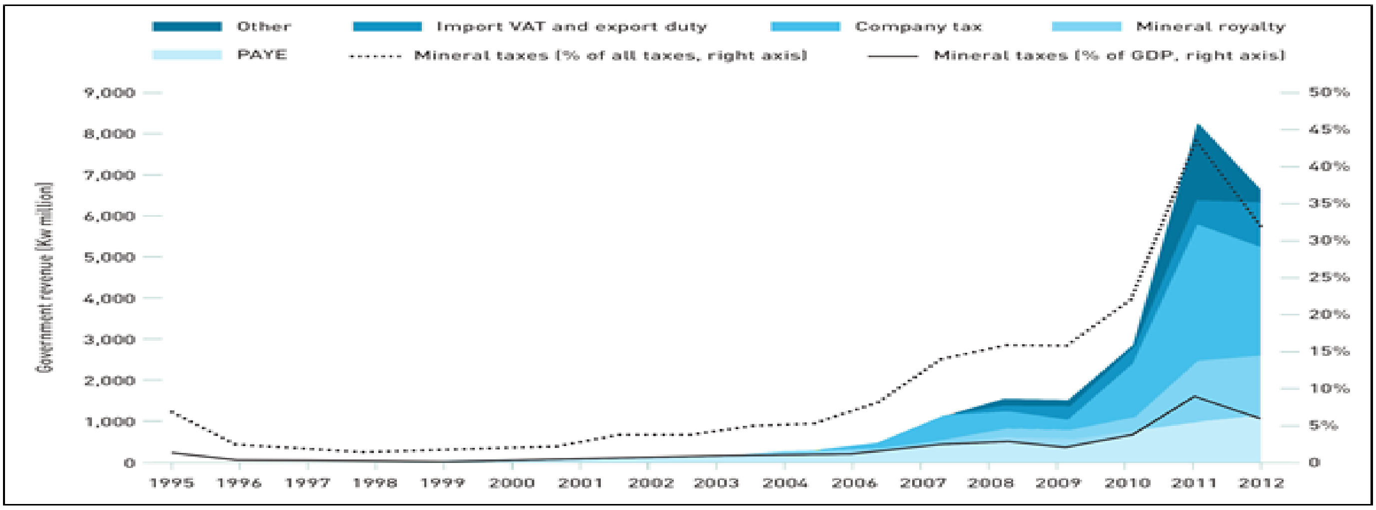
In 2013, Zambia's extractive revenue was US$ 1.5bn annually and represented 30 per cent of total government revenue.

While the pre-2008 period is characterized by generous concessions for private sector companies and ineffective management under the state ownership, Zambia introduced various measures to increase efficiency and to widen the base for its government revenue. Zambia implemented institutional reforms such as the creation of a large taxpayers' office and a gradual strengthening of its revenue collection framework. Tax administration today is relatively effective, and significantly reduced tax leakages compared with other African countries (Chamber of Mines of Zambia and ICMM; 2014).

The Mines and Minerals Act 2008 is a key legislation that paved the road of this paradigm shift. This started with introducing:

- A graduated windfall tax levied at a rate of 25 per cent on gross proceeds when the copper price exceeds US$ 2.50 per pound; 50 percent when the copper price exceeds US$ 3.00 per pound; and 75 per cent in excess of US$ 3.50 per pound. The windfall tax however was withdrawn in 2009, largely due to the effects of the financial crisis that began in 2008.
- A revision of the royalty rates that first increased to 3 per cent and since 2012 are set at 6 per cent.
- A revision of the corporate income tax rate of natural extractive industries, increasing it from 25 per cent to 30 per cent. Simultaneously, the rate applicable for non-mining sectors was reduced to 30 per cent from 35 per cent.
- A new variable profit tax rate under which the marginal tax rate would rise from 30 per cent to 45 per cent when taxable profits exceed 8 per cent of gross revenue.

Zambia: Fiscal revenues from the mining sector, 1995–2012



Source: ICMM, 2014, based on original data from the Zambia Revenue Authority.

- A withholding tax on interest, royalties, management fees and payments to affiliates or subcontractors for all mining companies was reintroduced and set at a standard rate of 15 per cent. Reduction of capital allowances from 100 per cent of expenses to a conventional 25 per cent per annum (and deductible only in the year production commences rather than in the year when the expense is incurred).
- Hedging as a risk management mechanism that is treated as a separate activity from mining.

The abolition of the windfall tax is an example of political economy implications. Introduced in 2008 and abolished the year after in the aftermath of the global financial crisis and as a result of increased threats by TNCs to lower investments, to close mines and to take legal action against the measures. The table below summarizes the main shift in the taxation of natural extractive industries.

Measure/Year	2006	2010
Royalty	0.60%	6%
Corporate Income Tax	25%	30%
Variable Income Tax	No	Yes
Windfall tax	No	No*
Custom duties	Exports = 0	15 % for unprocessed copper
Income of foreign subcontractors & interest	0%	15%

Note: * Introduced in 2008, but then abolished after the global financial crisis. Source: Simpasa et al., 2013, based on Zambia Revenue Authority and IMF, 2012.

An additional legislation aiming at curtailing capital flight and the underreporting of mineral earnings, was enacted in 2013 by the Zambian Government. The law applies to all international transactions, including profits, dividends, remittances, loans to non-residents and investments abroad by persons resident in Zambia.

Among mining countries (excluding petroleum) world-wide, Zambia's mining receipts are the second highest after Botswana, and higher than revenues of the Chile, Democratic Republic of Congo or Guinea.[1]

In the year after the introduction of the 2008 Act, tax collection for the mining sector did not meet the expectation, with an increase from KW 1.1 billion in 2007 to KW 1.5 billion in 2008. The main reasons for this result were delays in tax payments due to disputes concerning the Act, combined with a fall in copper production due to the worldwide crisis. Since then, government revenues have improved considerably, from less than KW 1 billion per year before 2008 to KW 6.619 billion in 2012.

Natural resource taxation and social protection

The government of Zambia emphasises health, education and social protection as a means to achieve their developmental goals. The 2014 budget confirms the government's increase in spending on health, education and social protection. As illustrated in the table below, the government increased its total spending on Health, Education and Social Protection from KR 8,086 million (29.2 per cent of total budget) to KR 14,018 million (32.9 per cent) in 2013.

	2011 (in million KR)	% of budget	2012 (in million KR)	% of budget	2013 (in million KR)	% of budget
Health	2,579.90	9.30%	3,638.10	11.30%	4,228.40	9.90%
Education	4,850.50	17.50%	5,626.80	17.50%	8,607.00	20.20%
Social Protection	655.6	2.40%	892.2	2.80%	1,183.00	2.80%
Total	**8,086**	**29.20%**	**10,157.10**	**31.60%**	**14,018.40**	**32.90%**

Furthermore, the government increased the budget for social cash transfer schemes substantially, from KR 55 million in 2012 to KR 199.2 million in 2014. These substantial shifts in Social Protection Spending can be linked to both a change in leadership as well as to an improved fiscal position that has been enabled through significantly increased government revenues from natural resource taxation.

Further, the government has taken steps towards developing a social protection policy with rights-based entitlements and created additional fiscal space for social protection by abolishing fuel and maize miller subsidies. Former patrimonial social protection programmes have been reformed to more structured and transparent programmes.

Conclusion

The case of Zambia exemplifies that resource rich developing countries can substantially expand fiscal space for social protection and other socio-economic expenditures. Taxing natural resource extracting industries allowed the Zambian government to improve their fiscal position and created the basis for the expansion of their social protection system.

Taxing natural resource extraction is one of the many alternatives to expand fiscal space for social protection that countries have. Governments normally use a mix of taxes and social security contributions to fund social protection, combined with other options explained in the paper "Fiscal Space for Social Protection: Options to Expand Social Investments in 187 Countries".

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