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A COMPACT FOR ASSURED AND SUSTAINABLE FINANCING OF SOCIAL PROTECTION FLOORS IN DEVELOPING COUNTRIES

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Abstract

This paper proposes a policy compact between IMF and interested developing countries in which individual countries would adopt national policies to sustainably finance appropriate "social protection floors" over the medium-long run and the IMF would assure that during times of stress caused by economic crises or natural calamities adequate funding would be available to deliver the expenditures needed. To prepare for times of stress, governments would issue a significant part of their sovereign debt with triggers that would automatically defer debt servicing on the finding of a crisis moment and/or quickly receive funds from a new pre-arranged credit line at IMF.

In many countries, levels of "social protection"—generally defined to include government cash transfers to dependent populations—have not been realized as promised and it is possible that governments will also fail to deliver on their promises in future. Much discussion of this threat pertains to the impact of demographic trends on old-age pensions and insurance programs that traditionally have depended on mandatory financial contributions by the shrinking share of the population that is in the labor force (Amaglobeli et al, 2019; ILO, 2017). While that problem mainly affects middle and higher income countries, there is another component of social protection that is also endangered, especially in low and middle-income countries. These social programs specifically aim to provide a minimum or basic level of financial support for the aged and children in need, as well as for people of "active age" who are unable to provide for themselves. This basic level of support has been called the "floor" of social protection and it is usually financed out of tax revenues.

Of particular importance, many developing country governments have been challenged to assure adequate and continued funding of whatever floor of social protection

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they offer. This has especially been the case during the recent decade of international pressure on governments to impose fiscal austerity. This paper proposes a way for the international community to encourage governments, in particular, of developing countries, to adequately and sustainably fund the collection of specific policies and programs that constitute their floors of social protection. As social protection is a fundamental national responsibility, governments will necessarily devise their policies and programs in accordance with national priorities and circumstances. They should also be guided by the recommendation of the General Conference of the International Labor Organization (ILO) as to the appropriate scope, content, implementation and oversight processes for social protection floors (ILO, 2012). However, while some countries may find it hard enough to adequately fund their floors of social protection during "normal" times, many of them will struggle even harder to meet their typically larger social protection needs during temporary periods of national difficulty. The proposal is especially concerned with ameliorating that situation.

The proposal would offer a quid pro quo of an International Monetary Fund (IMF) guarantee of access to quick-disbursing international financial resources on appropriate terms in times of crisis to countries that have nationally designed and adopted for normal times a social protection floor (SPF) that is adequate, well-designed, efficient, and sustainably financed. As such, the offered quid pro quo should strengthen the argument in national policy debates for more adequate and sustainable social protection programs. In addition, the proposed international financial reforms should help, however modestly, to fill a gap in the international financial policy architecture that has been made manifest by the high degree of volatility in the global economic and financial system, as well as by global health threats and the environmental catastrophes that seem to have been worsened by global warming.

The proposal envisages that prior to adoption of the compact, the governments of individual countries will have devised in consultation with their domestic stakeholders an adequate, well-designed and effectively provided floor of social protection. Governments might be assisted, when so requested, by the international organizations specialized in social protection and public expenditure efficiency. As these programs would entail guaranteed entitlements, governments will need appropriate and effective fiscal systems to provide enough annual resources during normal times to fully cover the necessary budget allocations for the SPF, as well as for the country's other essential public services. The governments might thus need to reform and strengthen their fiscal systems, which could draw on the expertise of the IMF and other relevant international organizations, again in appropriate consultation with domestic stakeholders.

The IMF would then be invited to assess the sustainability of the SPF with a view to finding it to be "sustainable with high probability" (a term already used by IMF in another context), at which point the country and the IMF could enter into the compact. The government would agree to regularly monitor the program with its domestic stakeholders within its normal domestic political processes, as well as in cooperation with the IMF and other relevant international expertise so as to help assure its continued effectiveness and financial viability. In exchange, the Fund would assure that during periods of economic stress or natural catastrophe, appropriately defined in the compact, the government would be able to quickly access a suitable combination of new official loans and/or sovereign debt relief which would allow it to meet the enlarged fiscal demands of its social protection floor.

At this point, some readers might think, "Forge a compact with IMF for social protection? What are you smoking?" My answer is that IMF has just recently opened a door for greater cooperation with its member governments and other international organizations to boost national social protection programs that the proposal suggested here could help nail in the open position. The IMF is also uniquely powerful among international organizations, so prospects are good that compacts with IMF would be honored. The proposal is nevertheless made with eyes open.

Why this, why now?

In this world in which continuous employment is less secure and people in countries at all income levels spend more years pre- and post-employment, the need for adequate and sustainably financed national social protection policies should hardly be controversial. Indeed, the 100th Anniversary ILO Conference in June 2019 included "universal access to comprehensive and sustainable social protection" as part and parcel of how to strengthen "the capacities of all people to benefit from the opportunities of a changing world of work" (ILO, 2019, paragraph III.A).

In addition, the world's governments have come to a consensus on basic economic criteria for social protection programs, as reflected by the recent joint statement of the United Nations Member States meeting at the specialized Financing for Development Follow-up Forum in New York in April 2019, which included the following:

> *We emphasize the importance of ensuring that social protection systems and measures for all, including floors, are consistent with national development strategies, and are well designed, efficiently operated, responsive to shocks, and sustainable in the long term* (United Nations, 2019a, paragraph 9 of the intergovernmentally agreed conclusions and recommendations).

Nevertheless, governments continue to be challenged to realize these aspirations. In some cases, governments could not themselves afford to adequately expand support in response to natural catastrophes, such as hurricanes, earthquakes or pandemics, and international emergency support was not sufficiently or quickly provided.[1] While there have been improvements over the past decade in quick-disbursing international support to cope with such emergencies, not all countries are eligible for the support, which has been less than needed, or can afford the financial and policy terms on which it is offered (United Nations, 2018, pp. 147-158).

Moreover, sometimes governments have had to cut back their social protection

[1] Jim Yong Kim, former president of the World Bank, in announcing a new anti-pandemic lending facility, noted that because international resources were unavailable for three months after the Ebola outbreak, the number of cases expanded by 10 times and the cost of containment reached $10 billion (Kim, 2016).

outlays in response to more conventional economic stresses. In some of those cases, governments had promised social protection benefits beyond what projected public revenues would finance. Such countries eventually found themselves cutting back social protection rather than increasing their efficiency or sufficiently raising public revenues to make the outlays sustainable. These countries need a transition to a fiscally sustainable and adequate social protection floor and the international community can help them make that transition with technical assistance and official financial support.[2]

In other countries, social protection policies that were not considered an excessive economic burden in normal times were suddenly deemed so when economic conditions worsened and fiscal austerity was adopted. In those situations, expenditure on the SPF should be protected and even expanded as warranted during the time of additional need. The proposal to be elaborated here would specifically address that situation and assure adequate financing for the SPF, which will also moderate the degree of austerity required for the return to sustainability.

In addition, the proposal would contribute, albeit modestly, to the needed reform of the international financial policy architecture, which has not fully responded to the needs of today's more volatile world (Ocampo, 2017, especially chapter 5). In this regard, it entails additional ways to assist countries during crises through a reform of IMF lending opportunities and the easing of sovereign debt-servicing burdens, and it proposes to do so in a way that would both maintain policy credibility and temper unnecessary declines in economic activity.

Austerity is rarely a policy of choice but becomes inevitable when tax revenues falter (as from a collapse of international prices of key commodity exports) and when external creditors lose confidence in the country's repayment capacity and decide not to expand lending to cover the revenue shortfall. In those circumstances, the IMF typically offers financial assistance, but on condition that an austerity program is adopted to reduce the fiscal deficit and rather quickly (Ortiz et al., 2015). From a social perspective—indeed a human rights perspective—and from an economic stability and growth perspective, this is unfortunately rigid. It is also a policy that IMF itself decided to question.

Austerity, finance and the IMF

The recent wave of rethinking in the IMF about its adverse impact on social protection began with a critical assessment by the Independent Evaluation Office (IEO) of the Fund (IMF, 2017a), surely prompted by numerous critical studies[3] and politically contentious developments in several member countries.[4] In response, the Fund

[2] Such situations might warrant a multi-year internationally supported adjustment program, which could draw on the ideas in the section of this paper below on national policy development before qualifying for the compact, as well as be an instance of the new IMF strategy on social spending, also noted below.

[3] Quite a few of the critical studies were collected as background for the Independent Evaluation Office policy review (Wojnilower, 2017).

[4] Press and civil society authors have noted the destabilizing political developments set off by austerity programs (or proposed programs) in such countries as Argentina, Egypt, Greece, Haiti, Iran, Jordan, Kyrgyzstan, Nicaragua and Tunisia (e.g., see Global Coalition for Social Protection Floors, 2019; Time Magazine, 2018; Mossalem, 2015).

management and its Executive Board agreed to revisit how IMF policymaking impacts social protection in its member countries, while broadening the scope of its review to also include the Fund's impact on basic education and health spending. Two years later, the Fund has adopted a new strategy to guide its engagement on these categories of social spending (IMF, 2019d). It intends to follow up by end-2020 with a set of guidelines for use by Fund staff in their discussions with governments during annual "surveillance" reviews and in negotiating conditions for loans to address economic crises.

Much of the new IMF policy involves intensified technical assistance to countries seeking to adopt *adequate*, *efficient* and *financially sustainable* policies that will provide a floor of social protection and basic education and health services. The strategy involves assistance to countries in planning their basic social protection, health and education programs, in closer cooperation than in the past with international institutions that have more expertise on specific social policies than the Fund. The Fund's own assistance would mainly focus on government planning and budgeting of the basic services and cash transfer payments such as for social security, plus advice on improving public expenditure efficiency and resource mobilization for fiscal sustainability over the medium-to-long run.

In those instances in which governments find it necessary to seek an IMF loan, the "conditionality" associated with the loan should now consider "measures to offset the adverse effects of adjustment on poor and vulnerable households, and to enhance the political and social sustainability of programs," as noted in the summary of the Executive Board discussion of management's proposed new strategy on social spending. Executive Directors also "called for appropriately sequencing reforms to cushion the impact on the vulnerable while noting that the nature and extent of conditionality should be informed by a country's macro-fiscal context, political economy considerations, and social objectives" (IMF, 2019, summary of the Executive Board discussion).[5]

The IMF conditionality is accompanied by loans that are offered at a variety of interest rates and loan maturities, depending on the Fund's assessment of the borrowing country's needs and financing constraints. It does not give money away. Thus, IMF may hesitate to lend to countries that already have heavy sovereign debt burdens. More precisely, IMF has adopted a policy on lending that distinguishes among countries based on its assessment of whether the country's sovereign debt is "sustainable with high probability", "sustainable but not with high probability", or "unsustainable".[6] In the first classification, the country is deemed able to absorb the interest and principal repayments that would come with new IMF lending. In the third case, the government is deemed unable to manage the debt it already has accumulated so that debt reduction is required; the

[5] Countries adopting the proposed compact could avoid entering into conditional IMF loan programs, although one may envisage circumstances when their crises are so profound that they require protracted assistance. In such cases, as well as for countries transitioning to a compact and for non-compact countries, the Fund should protect the social protection floor by including social protection indicators in the closely monitored "quantitative performance criteria" as opposed to the less demanding "indicative targets" or "structural benchmarks" (for background, see IMF, 2019d, pp. 14-18). While the nature of conditionality on social spending during IMF adjustment programs is an important topic, it is outside the purview of the compact proposal per se.

[6] These categories pertain to middle and high income countries. The comparable categories for low-income countries are low risk, moderate risk, high risk and in debt distress.

only way for the government to repay new IMF debt would be to make deeper cuts in the other outstanding debt.

The intermediate classification requires the most difficult judgments. One option that has been considered for such cases is to “re-profile” the country’s debt servicing obligations, i.e., delay the payments falling due in the near term with a view to making subsequent assessments about whether additional debt relief measures would be needed (IMF, 2019c, pp. 26-34). Fund staff have concluded that countries that undertook re-profiling as part of their macroeconomic adjustment programs during 2011-2016 underwent less onerous fiscal adjustment and experienced more economic growth than countries that sought to make all their debt-servicing payments despite the strain; in addition, creditors who re-profiled ultimately lost less than they would have lost had they delayed debt restructuring (IMF, 2019c, paragraphs 25-30 of the supplementary information).

While the Fund has found that re-profiling can be a useful complement to IMF loans for some countries, there is a shortcoming in that the revised interest and principal repayment schedule must be approved by the creditors. This will take time, and the extent and duration of agreed relief may thus be uncertain. Moreover, most developing countries have multiple foreign creditors, official and private. Unless only one class of creditors is targeted to give relief, any change in the contracted debt servicing must be negotiated with each group, which could require re-profiling approval of possibly many thousands of bondholders and possibly hundreds of bank lenders, as well as possibly many bilateral government creditors. Nevertheless, re-profiling has been accomplished in a number of cases (ibid.).

Sovereign bond contracts and bank loans specify how to go about agreeing to adjust the repayment terms when situations warrant. The contracts tend to become standardized, following models, as for example recommended by the International Capital Markets Association (ICMA). In the case of government creditors, most decisions are taken in the Paris Club, an informal group of creditor governments serviced by the French Treasury. While the Paris Club has adopted sets of common terms of relief to apply to different categories of countries, the indebted government still has to negotiate detailed legal changes in the terms of each loan with each creditor; this last step can go quickly, but may not always. Moreover, although in the past virtually all government creditors were members of the Paris Club, its members today account for a shrinking share of sovereign debt owed to governments. In short, re-profiling can become complicated. It is one factor that argues in favor of pre-agreed country compacts with IMF.

Why compacts with IMF and why only for social protection floors?

Advocates for deeper international financial cooperation on social protection usually do not specify a central lending role for IMF, but rather imagine situating such an activity in the United Nations or in a free-standing entity (e.g., de Schutter and Sepúlveda, 2012; Greenhill et al., 2015). The IMF has traditionally been perceived as either neutral or disinterested in the social consequences of its policy imperatives in countries. While there may well be different views within the Fund and among its governing board members on involving IMF in social policy in member countries, the new institutional view seems to offer an opportunity worth exploring for new progress in social protection and towards poverty eradication.

The IMF's fundamental purpose since it opened its doors in 1945 has been to promote economic stability in the world, facilitate international trade, and promote high levels of employment and income (IMF 2016, Article I). In addition, IMF's member countries have all signed onto the 2030 Agenda for Sustainable Development at the United Nations and its associated sustainable development goals, including ending poverty and hunger everywhere, and ensuring healthy lives and quality education for all (United Nations 2015a). Basic social spending is virtually everywhere a significant share of government budgets. Social spending is thus what IMF calls "macro-critical" and unavoidably a concern of IMF. The Fund is now committed to pay more attention to the content and fiscal sustainability of those macro-critical social services and cash transfers and to cooperate more with the more specialized international organizations in so doing.

However, while IMF has broadened the scope of its new policy beyond the social protection focus of the IEO study that prompted the policy review, the proposal being made here is restricted to the original IEO scope, indeed narrowing it further to guaranteeing "floors" of social protection. Although education and health are also essential public services, SPFs that give cash transfers to individual beneficiaries are proven means to reduce poverty and help reduce the number of people falling back into poverty after first escaping it (United Nations, 2018a). Cash payments are also attractive in that the cash provision leaves it to the household to manage its own basic consumption needs, and thereby interferes less in national development planning and market processes compared to direct provision of, for example, international food aid that can undermine local farm economies.

In addition, cash transfers can increasingly be delivered more reliably, efficiently and speedily than in the past. This is thanks to the spread of personal accounts at financial institutions, which can be accessed from "brick and mortar" branches, automated teller machines (ATMs), retail agents (as in local shops) and payment services that are increasingly available on mobile phones that link to financial institutions. While the poorest and most remote populations in some countries may have difficulty accessing such financial services, the number of excluded people continues to shrink (IMF, 2018). Thus, once the eligible population is identified, there is good reason to believe that the funds can be more reliably and speedily delivered to beneficiaries today than when the cash had to change hands several times as it moved from the central government to the final recipient.

Another reason to focus the proposal on social protection floors is that delivery of cash transfers can easily be increased to meet temporary additional needs. The government only needs to place additional funds in the beneficiaries' personal accounts. Boosting cash transfers is also an equitable way for governments to stimulate their economies when they fall into recession, as most social protection beneficiaries will likely spend most of any additional cash benefit. This makes social protection a macro-effective as well as fair form of counter-cyclical financing.

International policy to prepare for the compact

The essence of the compact is a promise on the part of a participating government to maintain an adequate, efficient and sustainably financed social protection floor that it will monitor over time, as well as jointly with IMF, in exchange for which IMF promises to help assure that sufficient financial resources will be available to meet the needs of the social protection floor during crises. Depending on the national situation, the crisis resources could take the form of quick-disbursing loans by IMF or a re-profiling of debt servicing obligations or a combination of both, together with additional international financial assistance depending on the severity and duration of the crisis.[7] Thus, before countries would enter into the compact, IMF would need to be able to offer assurances that it could deliver on its part of the bargain. That, in turn, pertains on the one hand to modification of certain IMF lending facilities or adding a new one, and on the other hand to more widespread adoption of an innovative contract for sovereign borrowing.

Adapt IMF lending facilities

The standard IMF loan is a "stand-by arrangement" ("stand-by credit facility" for low-income countries) in which the borrowing government agrees to undertake a set of policy changes and the Fund agrees to provide loan funds, usually released in "tranches" as evidence accrues of implementation of the promised policy changes.[8] As there can be a protracted period of negotiations before agreement is reached on the "conditionality" that accompanies the stand-by loan, these facilities are not appropriate when quick-disbursing financial support is needed, as for countries that have adopted a social protection compact. However, the IMF also has two loan facilities that do offer quick-disbursing funds without a negotiated adjustment program, albeit in relatively small amounts. One is called the "rapid financing instrument" which all member countries can access; the other is for low-income countries and is called the "rapid credit facility". These facilities aim to help countries facing such emergencies as "commodity price shocks, natural disasters, conflict and post-conflict situations, and emergencies resulting from fragility" (IMF, 2019b). While important as a source of immediate humanitarian and social support, access to these facilities will usually not be sufficient to address the potential needs of a country in a social protection compact with IMF. The country might need access to larger amounts of international funds over longer periods to sustainably maintain or expand its social protection floor during the crisis and recovery period.

In fact, the IMF has also designed two loan "windows" that are closer to the structure that could serve for assuring social protection financing, although they are meant to serve another purpose. Prior to accessing those facilities, which are called the "flexible credit line" and the "precautionary and liquidity line", the Fund pre-approves a country's policies. It then offers a potentially very large credit line on which the country can draw if

[7] The precise combination of IMF loans and debt re-profiling would be based on the latest IMF assessment of the country's debt carrying capacity, which would be informed by its holdings of foreign exchange reserves, possible fiscal buffers and other criteria, as well as the envisaged severity of the crisis.

[8] These loans are meant to address policy changes that can usually be implemented in under two years; in addition, the "extended fund facility" and "extended credit facility" for low-income countries are meant to accompany adjustment programs lasting usually up to four years; the low-income facilities currently charge zero interest (IMF, 2019).

needed. The facilities are meant to discourage and offset a potential panic of private creditors in a country that has a fully open capital account in its external payments regime and is thereby vulnerable to an economic crisis that would be caused by a massive withdrawal of funds from the country. In fact, the policy conditions that have to be met to qualify for these credit lines are quite demanding and only five countries have obtained either credit line since they first became available in 2009 and 2011.[9]

Building on this experience, the IMF could design a financing facility that guarantees funds would be available to maintain a compact government's commitment to its SPF during crisis periods. In particular, the Fund could combine elements of its flexible credit line and rapid financing instruments. For example, while all countries can access the rapid instruments, countries having adopted the social protection compact might thereby pre-qualify to draw more extensively and over a longer period from the rapid facilities or from a newly denoted loan window. IMF has already accepted as principles for its lending operations that it extends loans for social emergencies and that it pre-qualifies countries to rapidly draw a large amount of funds if needed. What would be new is in reducing the scope and intensity of the pre-qualification conditions from what are now required for having access to a credit line and opening a potential credit line to low-income as well as middle-income countries.[10]

While occurrence of a hurricane of specified dimensions and damage can be explicitly defined for activating access to the facility,[11] additional automatic triggers can be envisaged, such as specified declines in commodity export earnings.[12] Another approach to pulling the trigger that opens access, however, could be a joint declaration of need by IMF and the country's authorities, guided by pre-set fixed triggers. This approach would be both flexible and credible, allowing judgment of need, as when conditions just miss the trigger guidance but nevertheless warrant opening access.

Introduce standardized state-contingent bonds with triggers

As discussed above, IMF recommends that countries with serious sovereign debt burdens and facing economic adjustment needs should consider negotiating a re-profiling of their interest and principal payments. A less complicated option than the required case-

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[9] Colombia, Mexico and Poland have obtained the flexible credit line, and the Republic of North Macedonia and Morocco have obtained the precautionary line; only North Macedonia has drawn funds from its credit line (in 2011, repaid by 2013), suggesting that there are indeed shortcomings in the design of the facilities (Birdsall, Rojas-Suarez and Diofasi, 2017).

[10] In a paper for "Think 20" (T20), the research network affiliated with the Group of 20 governments, Gao and Gallagher (2019) proposed that the G20 should "address the absence of a precautionary instrument for low-income countries (LICs) at the IMF." The final T20 communiqué did not include that recommendation.

[11] Specifying the events that would open access to a credit line has some similarities to an insurance policy that pays the insured a pre-specified amount when a specified event occurs, called a "parametric" policy, as opposed to an insurance policy that indemnifies the insured based on an assessment of damages caused by the event (Swiss Re et al., 2018). There has been considerable exploration of parametric insurance policies in the public sector, regarding hurricanes, droughts and other types of untoward events (World Bank, 2017). The main difference is that countries purchasing the insurance must pay annual premiums to qualify for payment in case of need, while the user of the credit line has to repay the loan with interest.

[12] In the 1960s and 1970s, IMF put considerable analytical effort into measuring temporary "shortfalls" in export earnings that were deemed beyond a member country's control, which set the scope of prospective quick-disbursing IMF loans from its Compensatory Financing Facility (Goreux, 1980).

by-case negotiation has been much discussed in the legal financial literature and even applied in a few instances. This option employs a form of what has been called “state-contingent” debt, as the amount and/or timing of relief from debt servicing would be contingent on a specified “state of the world” occurring. This approach can meet our needs. Specifically, it is proposed here to build into external debt contracts an automatic deferral of debt servicing payments when a specified negative condition occurs.[13] Such contractual clauses, most prominently covering hurricane risk, have already been included in bonds issued as part of debt restructuring by Grenada and Barbados.

Official creditors could build automatic re-profiling triggers into their loan agreements with developing country borrowers as a policy decision. In fact, the Agence Française de Développement introduced a variant of this concept through its *prêt très concessionnel contra-cyclique,* which it has offered to a number of low-income African countries. In these loans, if the borrowing government experiences an external shock that significantly reduces its export earnings, it may delay scheduled repayments and add them onto the end of the maturity of the loan.[14] While other creditor governments have expressed interest in offering such loans, none has done so thus far.

For many developing countries, private rather than public sources of finance are now or are expected to become the major source of external sovereign borrowing. None have yet issued state-contingent bonds outside of a sovereign debt restructuring negotiation, although the law firm Clifford Chance (2018) has proposed a set of standard hurricane clauses for ICMA consideration. It seems the hesitation on the part of sovereign borrowers to float such a bond is not legal but financial. That is, borrowers fear that buyers of such bonds would demand a significantly higher interest rate than for standard bonds. No one knows if that fear is justified.[15]

The only way to see the net impact of factors pushing the prospective interest cost up and down is for some government or governments to actually go to the market and issue bonds with triggers. Experience with other changes in bond contracts suggest there might be an initial higher cost that would erode as the market absorbs the change and it becomes

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[13] Another type of state-contingent debt that has also been much discussed is linking interest payments to the rate of growth of the country’s gross domestic product (GDP). In such cases, bonds or loans would carry a base interest rate to which a variable amount would be added or subtracted depending on the growth or decline of GDP. While sovereign bonds have been issued with warrants that would increase payments to bondholders in the event of stronger than expected economic growth, no issue has been made yet that would decrease payments in the event of disappointing economic activity. Concern has also been expressed about the reliability of a government’s GDP statistics if its debt-servicing obligations depended on the GDP number. While GDP-linked bonds nevertheless have various desirable characteristics, they do not fit the needs of the problem addressed in this paper as well as do bonds with a trigger mechanism to delay payments. For additional details on GDP-linked bonds, see Benford, Ostrey and Shiller (2018).

[14] The loan is structured to reduce a standard ten year grace period on a 30 year loan to five years fixed at the beginning of the loan and five years to be used at the discretion of the borrowing country, with delayed principal payments added at the end of the repayment period. Between their introduction in 2007 and as of early 2017, five African countries had availed themselves of 16 such loans, totaling €344 million; no country had invoked the payment delay option as of that time (IMF 2017, p. 17).

[15] On the one hand, bond buyers might demand a “risk premium” (higher interest rate) for being an early adopter of such bonds. On the other hand, the more of a country’s bonds that have the re-profiling clause, the less risk the country would miss payments on its standard bonds, tending to reduce the base interest rate.

standard “boilerplate” (“small print”) in the bond contracts. A prominent case in point, which took place in the early 2000s, was the introduction of “collective action clauses” (CACs) for making it easier to reach bondholder agreement on restructuring repayments on bonds issued under New York law when necessary. There was much controversy and considerable fear about how much more interest the market would demand to accept the new bond contracts. Mexico tested the waters in 2003, followed by others. The result was virtually nil additional cost at first, falling to nil (IMF, 2019a). What is needed for the case at hand is for some country to become a “first mover”, such as Mexico in the CACs case.

However, it has been difficult to find a first mover for issuing free-standing state-contingent bonds. Indeed, a tremendous amount of high-level politics was involved in moving sovereign bond issuers and the financial markets to accept CACs in standard New York law bonds (Gelpern and Gulati, 2010). Neither the market nor the issuers wanted to change despite clear deficiencies in reaching debt restructuring agreements under the status quo. By the same token, some degree of high-level political encouragement may be needed to introduce re-profiling clauses in standard bond contracts.

There are reasons to think, however, that a politically attractive case can be made for introducing re-profiling clauses that would become activated as needed for countries in a social protection compact with the IMF. The first reason is that the need for re-profiling would be decided jointly by IMF and the country. This should short-circuit complaints, such as were made about Argentina’s default in 2001, that it was unnecessary.[16] The answer would be that the international community credibly says that the re-profiling is warranted. In addition, there would now be an international assurance that the first use of the funds that creditors forego in the re-profiling would be to support the country’s social protection floor. The bonds would thus seem attractive to “ethical” investors in general and investors in particular who would not want to countenance imposing human rights abuses as a consequence of receiving debt-servicing payments (Herman, 2018b). There is reason to believe that there is a growing share of financial asset holders who might place themselves in those categories (Merler, 2018).

National policy to qualify for the compact

What should be expected of countries seeking to qualify for the compact? Actually, they should do nothing more than what they have already agreed they should be doing.

In particular, UN Member States at the International Conference on Financing for Development in 2015 adopted a paragraph in the Addis Ababa Action Agenda titled “delivering social protection and essential public services for all”, in which UN Member States said,

> *“We will 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*

[16] “What ‘price’ should creditors pay when a debtor decides—either opportunistically or for reasons of political expediency—that it will not honor its contractual obligations?” (Singer and Newman, 2005).

> *disabilities, indigenous persons, children, youth and older persons"* (United Nations, 2015, para 12).

While the governments at the UN did not specify how the countries should go about devising these policies, the present author would call on governments to draw upon inclusive, public and democratic processes, including "social dialogues", as defined by an ILO Convention (1978). In addition, a relevant body of policy experience on which countries could draw through technical assistance has been accumulated by ILO, UNICEF, the World Bank, IMF and other international organizations, as well as by donor governments and international civil society organizations and networks.

Governments would have to reach some difficult decisions, as on where to draw the line between social protection expenditures that should be considered part of the "floor" and those that belong "above the line" and could be financed differently, about which specific categories of social protection floors to cover, and whether the benefits should be available to all or only some of the persons in a given category (e.g., universally to all residents over a specified age or to the part of the aged population falling under a specified poverty level).[17] These are all highly sensitive political decisions that must be taken and should be "owned" by the population at large, since they will be called upon to pay for these benefits through taxation, at least in normal times. As additional experience is gained, countries would be able to legislate modifications of those decisions, assessing needs and taking advantage of improving fiscal capacities to strengthen the floor, drawing on lessons learned through monitoring over the years.[18]

It is also to be expected that social ministries of the government that will be responsible for the components of the SPF will enter into discussion with finance ministries and development planning offices, as the social protection floor will need to be fit within the overall fiscal policy. In other words, to assure delivery of nationally appropriate social protection floors over time, the requisite public expenditures must be incorporated as secure elements of government development plans, medium-term expenditure frameworks and annual budgets.[19]

In anticipation of this multifaceted challenge, governments committed in Addis to devise "cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks" (United Nations, 2015, paragraph 9). Governments added this step in order to prevent the Addis declaration of policy intentions from leading only to unfulfilled aspirations. Indeed, after a hiatus of some decades, there has been a resurgence of interest both by governments and international development

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[17] There is an especially intense controversy about the desirability of "universal" as opposed to "targeted" social protection policies. These controversies are put aside for the purposes of this proposal (but see IMF 2019d, paper IV). The proposal focuses instead on sustainably financing whatever social protection floor is domestically deemed adequate and efficient.

[18] Countries that decided to weaken the SPF at the expense of worsened poverty and social harm might be deemed to violate the compact. Guidance for maintaining a compact in good standing would necessarily be a part of a policy decision creating the compacts.

[19] Indeed, the public spending commitments embodied in the 2030 Agenda for Sustainable Development, which introduced the sustainable development goals (United Nations, 2015a), and in the Paris Agreement on Climate Change (United Nations, 2015b) must also be built into these documents.

organizations in strengthening techniques for preparing overarching development strategies and their attendant development plans, expenditure and revenue frameworks, and annual budgets (Herman, 2018a).

To this end and in a spirit of openness and collaboration, quite a number of governments have publicly presented their recent national experiences in devising sustainable development strategies at successive meetings of the High-Level Political Forum of the United Nations. While these official reports differ in scope, depth and frankness, there begins to be a database—including 188 country exercises as of July 2019—that may prove useful in further development of national strategic planning tools.[20] Moreover, the World Bank has employed a custom designed analytical strategy for identifying binding constraints and open opportunities for more effectively "ending absolute poverty and boosting shared prosperity in a sustainable manner" in over 100 developing countries. Although these reports are prepared as internal Bank documents, albeit in collaboration with national authorities and other stakeholders, they can also help country planners and policymakers in devising their sustainable development strategies and financing frameworks.[21]

While there can be great variety in the development plans that emerge from the strategies, they should not be a "shopping list" of desired investments but a coherent package of policies across all the dimensions of sustainable development. The plan should take account of interactions among sectors and the differential impacts of policies by gender and income class. They should also take account of the economic, financial, social and political risks that countries face in the world at large, both in nature and in the economy. These risks should be lessened and not exacerbated by poor policy design.

The plans also need to take account not least of the financial interactions among domestic sectors and externally. Governments thus need to track the likely requirements and implications of the plan on financial flows in and out of the country, on the external indebtedness of the government and private sector, on the overall debt burdens of the public, business and household sectors, on the institutional development of the financial sector, on the degree of financial sector fragility that regulations will tolerate, and on fiscal sustainability. Wary of such concerns, the Addis Agenda thus called upon countries to adopt "integrated national financing frameworks" (INFFs). While INFFs embody a broad concept, the Inter-Agency Task Force on Financing for Development (IATF), which services the follow-up discussions on the Addis Agenda at the United Nations, has been developing a broad methodology of building blocks and guidelines for developing INFFs, based on work of the UN Development Program, IMF, the World Bank and other IATF members (United Nations, 2019, chapter II).

While INFFs embody a comprehensive view of financial activity in a country, government finances are central foci and of particular importance to social protection compacts. That is, ways need to be devised to assure overall fiscal sustainability that also

[20] See the Voluntary National Review (VNR) database, Handbook for preparing VNRs and related documents at https://sustainabledevelopment.un.org/vnrs/.

[21] On the methodology, see Hausmann, Klinger and Wagner (2008). For the individual country studies, see https://openknowledge.worldbank.org/handle/10986/23099.

assures availability of adequate public revenues to cover the cost of the SPF in normal times, along with other national expenditure priorities. In many countries, this means increasing tax revenues. Indeed, the Addis Agenda itself emphasized the need for "significant additional domestic public resources" and Member States thus said they would welcome "efforts by countries to set nationally defined domestic targets and timelines for domestic revenue as part of their national sustainable development strategies." Governments at Addis then offered to "support developing countries in need in reaching these targets" (United Nations, 2015, para. 22). Furthermore, Member States committed in Addis "to investing in efforts to strengthen the capacity of national and local actors to manage and finance disaster risk, as part of national sustainable development strategies, and to ensure that countries can draw on international assistance when needed" (para. 62). In this spirit, several initiatives were launched in the context of the Addis conference to help countries better mobilize fiscal resources, including the Addis Tax Initiative, the Platform for Collaboration on Tax, and Tax Inspectors Without Borders, not to mention the further development of the medium-term expenditure frameworks and revenue strategies of the World Bank and IMF.[22]

This focus on mobilizing additional public revenues under the Addis umbrella parallels a more narrowly focused effort by official (Ortiz, Cummins and Karunanethy, 2017) and civil society authors (Herman, 2018) to identify sustainable sources of fiscal revenues explicitly for financing social protection floors. However, it seems most practical not to seek to identify or earmark specific tax revenues to cover social protection, but to view the necessary funds as coming out of general tax revenues and reaching "iron-clad" commitments to allocate the requisite funds to deliver the SPF.

In other words, the better strategy seems to be to "ring fence" the social protection floor within the annual budget based on expected need for the covered transfers, but with a caveat that the floor is an entitlement that must meet the demand when it temporarily expands during a crisis. Indeed, this sets up the budget for the SPF in a way that simplifies estimating the net additional revenue needed to respond to a crisis. Governments can then decide to meet that need by reducing non-essential current expenditures, postponing planned public investments, borrowing additional domestic funds or seeking the financial support of the compact with IMF.

In sum, national authorities, drawing on multiple international sources of technical assistance, can devise an adequate, well-designed, efficient, and sustainably financed social protection floor. It is for national policy makers, in consultation with relevant domestic stakeholders and in public dialogue, to prepare that policy as part and parcel of its commitment to a sustainable development strategy and integrated national financing framework. The proposed compact with IMF could offer an additional incentive to undertake that challenge.

[22] In all, a survey of IATF members elicited a list of 50 initiatives on public resources and debt, including the ones mentioned here (https://developmentfinance.un.org/INFFsupport).

Conclusion

The word "compact" can be given various meanings. The paragraph in the Addis Agenda that promises to deliver "fiscally sustainable and nationally appropriate social protection systems and measures for all" follows on a commitment to "a new social compact" (United Nations, 2015, paragraph 12). That phrase is not otherwise mentioned beyond that paragraph and has not received further intergovernmental discussion as far as this author understands. It is thus, at best, a vague aspiration.

The compact proposed here is more precise, more limited and more enforceable. In the same way that conditional IMF loans embody a political agreement between a member country and the institution, the compact would also be a political agreement, one that pre-qualifies the county to quickly reach a joint assessment with IMF when there is a need to access quick-disbursing loans and/or trigger a debt re-profiling. It would be necessary beforehand to devise standards and general guidelines to apply in such situations so that policymakers would be more confident of how the compact would operate, perhaps including a model compact agreement. Part and parcel of those guidelines is that IMF surveillance of compact countries would be no more intrusive than is the case for non-compact countries, as the role and mandate of IMF as regards domestic policymaking is limited. Indeed, IMF member governments would in any event reject excessive intrusiveness.

Rather, the objective is to assist governments to honor the right to social protection, while introducing reforms at IMF that could help fill a gap in the international financial architecture that has become more visible as the frequency grows of crises that are not easily handled domestically, especially by small nations, owing to greater global financial and economic volatility, global health risks, and the disruptions of nature associated in part with global warming.

The proposed compact does, however, reflect a vision of a more cooperative world order in which countries work together intensively to address the major economic, social and environmental challenges of our time.

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