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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 sustainable fiscal policies over the medium-long run that would assure sufficient funds for appropriate "social protection floors" (SPFs), and the IMF would assure that adequate funding would be available to deliver necessary SPF expenditures during times of stress caused by economic crises or natural calamities. On the finding of a crisis moment, governments would quickly receive funds from a pre-arranged credit line at IMF and/or invoke an automatic deferral of debt servicing on sovereign debt issued with prearranged deferral triggers.

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 needs greater policy attention, 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 typically provided as part of annual government budgets funded from general tax revenues.

This paper proposes a way for the international community to encourage governments to adequately and sustainably fund the collection of specific policies and

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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).[1]

More precisely, the paper proposes that the International Monetary Fund (IMF) offer a compact to member countries that would guarantee access to quick-disbursing international financial resources on appropriate terms in times of crisis for priority support of their social protection floors (SPF) on condition that they have adopted an SPF that is adequate, well-designed, efficient, and forms part of a fiscal situation deemed sustainable over the medium-term. As such, the offered quid pro quo of automatic access to emergency finance for maintaining the SPF should strengthen the argument in national policy debates for adopting adequate, normally sustainable social protection floors. In addition, the international financial reforms that would form part of the compact proposal should help add assured resources in the increasing number of times of need caused by the volatility in the global economic and financial system, as well as by global health threats and the environmental catastrophes that appear to have been worsened by global warming.

There is no presumption in what is proposed here that most potential compact countries are sign-up ready as of this writing. There is much work to be done in many countries to sustainably raise their SPF to what would nationally be deemed an adequate standard, but there is also considerable interest and progress in countries to do so (ILO 2017 and World Bank, 2018). Moreover, there is a burgeoning interest in strengthening international cooperation to help governments strengthen their social protection systems,[2] as well as raise adequate tax revenues and overall strengthen their fiscal policymaking (United Nations, 2019). Far from a defect of proposing the compact today, creating the compact could offer a politically attractive way to incentivize quicker progress on relevant SPF and fiscal reforms. That is, governments that join the proposed compact could credibly promise that their social protections floors would henceforth function as intended "come hell or high water."

The proposal envisages that prior to entering the compact, individual governments will have devised in consultation with their domestic stakeholders an adequate, well-designed and effectively provided SPF. As these programs entail guaranteed entitlements, governments will also need to assure enough annual budget resources during normal times to fully cover the necessary allocations for the SPF, as well as for the country's other essential public services. The governments would thus also work to reform and strengthen their fiscal systems as a whole. In devising their reforms, the governments could request technical assistance from IMF, other international institutions, and civil society sources of

[1] While other terms are often used to refer to a country's collection of basic budget-financed social transfer programs, such as "social safety net" and "social assistance", this paper uses "social protection floor" to reflect the norms of the ILO recommendation and its aim to spread social protection to all in need, at least at a basic level (Cichon, 2013).

[2] See, for example, the efforts of the coalition of governments, international institutions and civil society organizations called "Universal Social Protection 2030," at https://www.usp2030.org/gimi/USP2030.action.

expertise.

At some point, the government would invite IMF to assess the sustainability of the SPF in the sense of the commitment of adequate funding for it within a sustainable medium-term fiscal framework. The assessment could be undertaken as part of the annual IMF surveillance exercises under Article IV of its Articles of Agreement. Following a positive assessment, the IMF could invite the country to enter into the compact. In exchange, the Fund would assure that during periods of economic stress or natural catastrophe, appropriately defined in the compact, and in the presence of balance-of-payments need, the government would be able to quickly access a suitable combination of new official loans and/or sovereign debt relief that would allow it to meet the temporarily enlarged fiscal demands of its social protection floor.

In joining the compact, the government would agree to transparently monitor the program on an ongoing basis in cooperation with its domestic stakeholders and within its ongoing domestic political processes. This could form part of its annual budgeting and the monitoring of its overall fiscal sustainability. The government would continue to cooperate with the IMF, as in its annual Article IV reviews, and with other international partners over time so as to help assure the program's continued effectiveness and financial viability. Indeed, as the national economy grows, the amount and range of covered services in the SPF should grow, reflecting increased capacities.

At this point, some readers might think, "Forge a compact with IMF to protect social protection? What are you smoking?" My answer is that IMF has just recently opened a door to greater cooperation with its member governments and other international organizations to boost national social protection programs. The proposal suggested here could help nail that door in the open position. The IMF is also uniquely powerful among international organizations, so prospects are good that compacts with IMF would be honored. Ironically, IMF could even come to be seen as a protector of programs that mainly benefit the poor, rather than as a threat to those programs. The proposal is nevertheless made with eyes wide 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.[3] 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).

Sometimes governments will cut back their social protection outlays in response to the onset of economic weakness. In some of those cases, governments may have promised social protection benefits beyond what honestly projected public revenues would cover. Such countries could then find themselves cutting back social protection programs rather than increasing their efficiency or sufficiently raising public revenues to make the outlays sustainable. Those 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.[4]

In other countries, social protection policies that were not considered an excessive economic burden in normal times suddenly are seen so when economic conditions deteriorate and fiscal austerity is adopted. In those situations, expenditure on the SPF should be protected and even expanded as warranted during the time of additional need. In some cases, countries can build up fiscal buffers that can be deployed to cover the ongoing and temporarily added costs of the SPF. The proposal to be elaborated here addresses situations presenting greater fiscal challenges to governments. It would specifically assure funds adequate to pay for the SPF during a crisis period, which would also moderate the degree of austerity required for the return to sustainability after the crisis eases.

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 particular, it entails additional ways to assist countries during crises through a reform of IMF lending

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[3] 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). This is just one instance of a broader problem in the voluntary system of international financial responses to humanitarian crises, which are usually at a substantially lower level than the identified needs (Development Initiatives, 2018).

[4] 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, as well as be an instance of the new IMF strategy on social spending, also noted below.

programs 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[5] and politically contentious developments in several member countries.[6] In response, the Fund 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 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 policies that are deemed adequate, efficient and financially sustainable and 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 other international institutions, including the World Bank, 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, 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

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[5] Quite a few of the critical studies were collected as background for the Independent Evaluation Office policy review (Wojnilower, 2017).
[6] 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).

political and social sustainability of programs," as noted in the summary of the executive board discussion of management's proposed 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).[7]

IMF conditionality is the standard quid pro quo for IMF loans, which 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. IMF 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 by which it may lend to a country beyond its normal access limits (i.e., lend to countries seeking "exceptional access"), but distinguishing between countries assessed to have sovereign debt burdens that are judged "sustainable with high probability" as opposed to "sustainable but not with high probability." In the first classification, the country is deemed able to absorb the interest and principal repayments that would come with new IMF lending. The second classification is more problematic and requires the most difficult judgments.[8]

One option for countries in the second category might be 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 money than they would have lost had the country delayed debt restructuring (IMF, 2019c, paragraphs 25-30 of the supplementary information).

While 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

[7] Countries adopting the proposed compact would usually avoid entering into conditional IMF loan programs, although one may envisage circumstances when their crises are so profound that they require protracted conditional 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.

[8] In addition, IMF and the World Bank jointly assess low-income country sovereign debt as low risk, moderate risk, high risk, and in debt distress. The categories are meant to guide official donors and institutions in providing loan or grant-financed assistance.

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 standardize how to do this, following guidelines, 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, ex-poste negotiated re-profiling can become complicated. It is one factor that argues in favor of bonds and loans with pre-agreed delay clauses. Such clauses likely also raise the "recovery value" of the loan in a crisis, while dispensing with the myth that the borrower will honor its obligation to pay all that is owed on time no matter what.

Why compacts with IMF and why focus on 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 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.[9] 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 reform 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 effective social protection floor that it will fund through a sustainable fiscal framework. In exchange, IMF promises to help assure that sufficient financial resources will be available to meet the needs of the social protection floor during crises. As said earlier, 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. However, before countries would agree to enter into such compacts, 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.

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[9] It is possible that starting-level SPFs might be deemed of less than "macro critical" size in some countries. However, even such countries should be able to qualify for the compact owing both to the commitment to maintain a sustainable overall fiscal situation, and because the assistance needed during a crisis would likely have a macro-critical impact on that country's fiscal situation.

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.[10] 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. 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" (RFI), which all member countries can access; the other is for low-income countries and is called the "rapid credit facility" (RCF).[11] 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, countries may well need larger amounts of international funds over longer periods to sustainably maintain or expand their 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" (FCL) and the "precautionary and liquidity line" (PLL), the Fund pre-approves a country's policies. It then offers a potentially very large credit line on which the country can draw if needed.[12] 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.[13]

Building on this experience, the IMF could design a financing facility that

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[10] 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).

[11] The initial loan under the RFI can be up to 37.5% of the country's "quota" in the Fund (the quota equals what the country is required to pay into the Fund, 25% in "hard" and 75% in domestic currency). An RFF-eligible country can borrow either 37.5% or 18.75% of its quota, depending on circumstances. RCF countries can borrow up to 60% of quota in one year in a natural disaster that destroys at least 20% of its gross domestic product. If need lasts beyond one year, countries can accumulate borrowings up to 75% of their quota under either loan window. In contrast, normal access to borrowing is 145% of quota in a year, with a maximum of 435% of quota outstanding at any one time; exceptional access above these limits is made available in certain situations.

[12] There is no access limit on the FCL and up to 250% of quota in one year and 500% of quota cumulatively for the PLL.

[13] 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).

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 occasioned by 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.[14]

As a hurricane of specified severity can be estimated to cause damage of a specified amount, the occurrence of such a hurricane can be taken as the triggering event for accessing a specified amount of funds from the facility.[15] Additional automatic triggers can be envisaged, such as specified declines in commodity export earnings.[16] Once the trigger value of one or more pre-set indicators is attained, the government could request to draw on the facility. The government would not be obligated to immediately draw the loan, although access would remain open for only a specified period. Also, if the deterioration in the indicator was less than but close to the trigger value, it would be sensible to allow the government to request a loan, perhaps of smaller size.[17] 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-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

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[14] 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.

[15] Specifying the events that would open access to a credit line has 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 with the use in this paper 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.

[16] 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 quick-disbursing IMF loans to help fill the gap from its Compensatory Financing Facility (Goreux, 1980).

[17] There is unavoidably a measure of arbitrariness in fixed indicator triggers, which begs to be addressed. For example, in 2017 the Caribbean Catastrophe Risk Insurance Facility (CCRIF) added a feature to its tropical cyclone and earthquake policies to provide "a minimum payment for events that are objectively not sufficient to trigger a CCRIF policy" (https://www.ccrif.org/content/about-us).

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.[18] Such contractual clauses, most prominently covering hurricane risk, have already been included in bonds issued as part of debt restructuring by Grenada and Barbados.

In addition, 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.[19] While other creditor governments have expressed interest in offering such loans, this author knows of none that 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.[20]

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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[18] Another type of state-contingent debt that has also been much discussed would link 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. One possible reason is concern that the reliability of a government's GDP statistics might be doubted if its debt-servicing obligations could be reduced by a disappointing 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).

[19] The loan is structured to reduce a previously 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 in the event of an export shortfall, 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).

[20] 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 any payments actually falling due, tending to reduce the overall 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 according to pre-set criteria, including participation in an SPF compact with IMF. This should short-circuit complaints, such as were made about Argentina's default in 2001, that it was unnecessary.[21] In addition, there would now be a credible commitment that the first use of the funds that creditors forego in the re-profiling would be to support the country's social protection floor. Such bonds would seem attractive to "ethical" investors in general and in particular investors 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 no more than what they have already agreed they should be doing, even if what they should be doing is more aspiration that achievement in many countries.

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*

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[21] "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 or the policies that would implement countries' other commitments to sustainable development,[22] they did call on governments to devise "cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks" (United Nations, 2015, paragraph 9). Governments added these steps in order to encourage countries to actually implement the Addis declaration of policy intentions and the 2030 sustainable development agenda.

Sustainable development strategies

It is to be expected that social ministries of the government would be responsible for the individual components of the SPF and would thus need to enter into a give and take with finance ministries and development planning offices on long-term, medium-term and annual budget negotiations.

Governments would have to reach some difficult decisions, such as on where to draw the line between social protection expenditures that should be considered part of the "floor" (and thus be treated as guaranteed entitlements provided to all in need) and those above the floor, which could be financed, provided and guaranteed differently. They would also need to decide about which specific categories of social protection 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).[23] Over time, as additional experience is gained and economies grow, countries should re-assess needs, take advantage of improving fiscal capacities, and further strengthen the floor.[24]

These are all highly sensitive political decisions that should be "owned" by the population at large, since they will be called upon to pay for these benefits annually through taxation. Governments should thus draw upon inclusive, public and democratic processes to help reach the policy decisions, including "social dialogues", as defined in the ILO Convention on tripartite consultations (ILO, 1978). In addition, countries could draw on a large body of policy research that has been accumulated by ILO, UNICEF, the World Bank, IMF and other international organizations, as well as by governments and international civil society organizations and networks.

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[22] These include the commitments embodied in the 2030 Agenda for Sustainable Development and its sustainable development goals (United Nations, 2015a), and those in the Paris Agreement on Climate Change (United Nations, 2015b).

[23] 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 agreed to be adequate, efficient and effective.

[24] Governments voted into office after a compact was adopted could decide to weaken the SPF at the expense of worsened poverty and social harm, which 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.

The social protection floor will thus need to be fit within longer-term development plans, medium-term fiscal frameworks, and annual budgets. It is pertinent, in this regard, that after a hiatus of some decades, there has been a resurgence of interest both by governments and international development organizations in strengthening techniques for preparing overarching development strategies and their attendant development plans and financing frameworks (Herman, 2018a). While there can be great variety in the planning documents that emerge from such exercises, 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.

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 in the Economic and Social Council 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.[25] Moreover, the World Bank has employed a custom designed analytical strategy for identifying both binding constraints and 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.[26]

Integrated national financing frameworks

The sustainable development plans need to take account of the financial interactions among domestic sectors and externally. Governments need to track the likely requirements and implications of the plan for 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 called upon countries to adopt "integrated national financing frameworks" (INFFs), as noted above. 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,

[25] See the Voluntary National Review (VNR) database, Handbook for preparing VNRs and related documents at https://sustainabledevelopment.un.org/vnrs/.
[26] On the methodology, see Hausmann, Klinger and Wagner (2008). For the individual country studies, see https://openknowledge.worldbank.org/handle/10986/23099.

government finances are central foci and would be of particular importance to social protection compacts. That is, governments should seek to assure overall fiscal sustainability that also 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" (United Nations, 2015, para. 22).

Governments at Addis also offered to "support developing countries in need in reaching these targets" (ibid.). 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.[27]

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 research (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 entail "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. Moreover, being able to automatically access external crisis funds obviates potential fights if the government instead tried to reallocate funds from other budget categories. One may assume that every dollar of the budget has a political constituency that would fight to retain its funding and that it would require a not insignificant time in the legislature or the courts to agree to the reallocation. Accessing the international SPF resources seems least disruptive of national policy as well as providing a countercyclical benefit.[28]

In sum, national authorities can and should devise an adequate, well-designed,

[27] 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).

[28] The precise combination of IMF loans and re-profiling of obligations to different creditors 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.

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.

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 than the UN recommendation. 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 promises that IMF will quickly respond to a warranted request to access quick-disbursing loans and/or specifies that passing a pre-set indicator level would trigger a debt re-profiling. It would be necessary before any specific bilateral compacts were signed that IMF devise standards and guidelines to apply in drafting such agreements, perhaps including the drafting of a model compact. Policymakers should be confident of how the compact would operate, including limiting the degree to which IMF surveillance would intrude on domestic policymaking. Indeed, IMF member governments would in any event reject excessive intrusiveness.

In all, 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, envisage a cooperative world order in which countries work together more intensively to address the major economic, social and environmental challenges of our time.

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