Social Protection: an essential building block to reduce inequality

The Sustainable Development Goals (SDGs) place a key focus on the pivotal role that the reduction of inequalities plays for ending poverty. SDG 10 explicitly aims to *Reduce Inequality within and among Countries*, recognizing that development requires sharing progress more widely with everyone, including the most disadvantaged groups in society. However, inequality has been rising in many countries, a trend that has benefitted especially those at the very top. And even where it has not risen in recent years – such as in many Latin American countries that strengthened their social protection systems – disparities remain vast. In some of the most unequal countries, the richest 1 percent hold more than 15 percent of national income. In South Africa for example, the income share of the top 1 percent has almost doubled since 1990 and currently lies just under 20 percent (World Bank, 2016). Excessive concentration of income and wealth at the top – which is even underestimated since much of it is not observed in official accounts or surveys – lies at the root cause of high inequality. Income and wealth inequality often go hand-in-hand with inequalities along other dimensions such as opportunities, access to services and resources, and political representation.

Reducing inequalities is important for development because the adverse impacts of high inequality undermine efforts to overcome poverty. Inequality endangers social cohesion and peace, it negatively affects economic, social and political participation and undermines trust in institutions. High levels of inequality also have adverse socioeconomic effects such as lowering social mobility and undermining progress in health and education outcomes (OECD, 2018; Easterly, 2007; Wilkinson & Pickett, 2010). As such, reducing inequality also contributes to the achievement of other SDGs such as SDG 1 (No Poverty), 3 (Good Health and Well-Being), 5 (Gender Equality) and 8 (Decent Work and Economic Growth). Similarly, global inequality remains intolerably high and exacerbates stubbornly high rates of extreme poverty (World Bank, 2018).

Reducing inequality requires redistribution

Strong social protection systems – alongside fair taxation and labour market policies that strengthen rights of workers for example through minimum wages and collective bargaining – are key instruments to address rising inequalities. In countries such as Sweden, Denmark and Brazil, the tax and transfer system reduces income inequality by up to 15 Gini points. This represents a reduction of 40 percent in Scandinavia and 25 percent in Brazil (Lustig, 2016; OECD, 2015.). The provision of public services further reduces inequalities for example in health and education. Upholding the right to social protection is all the more relevant in low- and middle-income countries (LMICs) and fragile settings where shocks occur more frequently and poor households are hit hardest by it. The objective, thereby, is to promote a shared idea of social justice: Article 22 of the Universal Declaration of Human Rights establishes the right to social security for everyone as "indispensable for his dignity and the free development of his personality" (UN General Assembly, 1948).

Social protection and inequality have a reciprocal relationship. While redistribution through social protection has the potential to reduce inequality in income, opportunities and access to public services, a high level of inequality can at the same time erode public support for it because inequality divides societies. When comparing systems of social protection across countries, it becomes evident that they differ strongly in the degree of redistribution they achieve. Equally important as the level of public spending is the specific design of fiscal policy including social protection. As such, two countries with the same level of government revenues and social expenditure can achieve vastly different degrees of redistribution. The degree to which benefits reach the poor and excluded people in society, the mode of financing and the design of tax systems all play a central role. Surely, redistributing resources from the top of the distribution to the bottom is not the only objective of social protection systems. They also serve to smooth consumption over the life cycle and in times of income loss due to risks such as unemployment or sickness. Vertical redistribution deserves, however, particular emphasis when it comes to achieving SDG 10.

Social protection reduces risk and vulnerability

Broadly speaking, social protection schemes can be classified into three different types. As a risk pooling mechanism, **social insurance** is typically confined to members who pay contribution to a common fund and thus gain entitlement to contingent benefits.

The primary objective of social insurance is to smooth consumption over the life course and in times of risk through income replacement. The most common schemes include pension, health and unemployment insurance. Often, the benefits an individual receives are linked to his or her previous contributions. For this reason and due to the confined membership, the degree of redistribution social insurance achieves is limited but, depending on the design, can be considerable. As such, even though high income earners may receive higher benefits upon retirement for example, contributions are often still levied progressively and function like an income tax. In health insurance, benefits respond to specific health needs, facilitating redistribution between the healthy and the sick. Similarly, in the absence of insurance, individuals may be thrown into poverty when a shock hits them so that the presence of insurance prevents inequality from widening. Further, many schemes require employers to contribute, thereby increasing fiscal space for redistribution.

Types of social protection schemes

Social insurance: is a mechanism to smooth consumption and protect members from risks such as unemployment, sickness or retirement. Typically, individual members receive benefits on the basis of previous contributions in the event that a risk occurs. Membership is often mandatory for a specified group such as formal sector employees.

Social assistance: are benefits that are granted to individuals or households without the need of prior contribution. Usually, eligibility is based on means-testing of need and funding comes from the general government budget. They are typically designed to cover a basic minimum and withdrawn as income rises.

Universal transfers: are given to anyone that fits certain criteria (such as citizenship, having children, a certain age or a disability) regardless of income or wealth. They are usually also paid out of general government revenue.

A challenge in the Global South is that social insurance schemes tend to be tied to participation in formal employment. This is why their scope and coverage are often limited – particularly for workers in non-standard and precarious forms of employment and workers in the informal economy. Social insurance schemes in LMICs thus tend to support the middle class. Increasing their redistributive capacities requires broadening their reach to include poorer people either through subsidizing them for those who are unable to contribute, providing higher replacement rates for low income earners and linking them more strongly with non-contributory schemes.

In contrast to insurance, receipt of **social assistance** is not tied to membership but is rather aimed at those in need because they fall under some income or poverty threshold. As such, their objective is to secure a minimum income and/or access to services rather than to maintain consumption close to previous levels as in the case of social insurance. They are typically financed out of the general budget. This is why social assistance tends to have a greater redistributive impact than insurance: it relies to a greater extent on the principle of solidarity, which states that everyone in society should pay according to their ability while receiving benefits according to their need.

The receipt of social assistance is sometimes tied to certain behavioural conditions such as sending one's child to school and making use of primary health care services as in the case of conditional cash transfers (CCTs) or proving one's job-seeking efforts as in the case of many unemployment assistance schemes. These conditionalities and the implications of means-testing bear the risk of excluding some of the most marginalized people, often women, who find it difficult to comply with conditionalities and administrative requirements – thereby undermining the very idea of providing a basic minimum. Targeting happens with exclusion and inclusion errors, administrative costs and may create stigma while furthermore promoting dependency if efforts to exit poverty are undermined by prospects of losing the transfer.

Universal schemes do not encounter such difficulties since they are not confined to narrow target groups but rather granted to all individuals that meet certain criteria regardless of own means, such as having children or being disabled. In principle, universal benefits are rights-based and reduce inequality by design: if everyone in an unequal society gets the same transfer, the spread in incomes will be reduced. In practice, their impact depends on the size of the transfer and will likely be smaller than that of targeted assistance since the latter ideally facilitates redistribution from the top to the bottom and, given the same budget, can be larger in size. For this reason, proponents of targeting argue that fiscal space – especially in countries with a tight budget constraint where high income earners often do not pay a fair share of taxes – is limited. In this sense, targeting provides means of channeling resources to those most in need and maximizing redistributive impact at lower costs. However, according to political economy arguments, universal transfers should receive higher budget allocations and be sustained by social consensus in the long run, thereby potentially yielding stronger redistributive results. Where poverty is widespread, universal transfers may further be more effective since the costs of targeting become disproportional. Which effect ultimately prevails is a country-specific empirical question.

Of course, social protection integrates a much wider set of policies than cash transfers and subsidies. Public services particularly in the field of health and education have huge redistributive impacts and allow disadvantaged people to improve their own starting position and break cycles of poverty that often persist across generations. Investing in social services that benefit the lower part of the distribution not only contributes to reducing inequalities in income but also those that run along other dimensions, such as gender, age and disability. Women and girls are not only at higher risk of being poor, in many countries they also suffer from lower access to education, receive less health care and are more likely to be found in unpaid care or low-paid precarious work environments. Social cash and in-kind benefits hence carry great potential for reducing gender inequality.

Social protection and domestic resource mobilization are inextricably linked

A key factor that determines the redistributive impact of a government's fiscal policy is the way in which revenues are generated to finance social protection and the provision of public services. Raising revenues is often treated separately from expenditure policies although when it comes to reducing inequality, the two are inextricably linked. Tax-to-GDP ratios are much lower in LMICs than in the Organization for Economic Cooperation and Development (OECD) region for example, which illustrates the overall lesser role of the state. Thus, apart from re-allocating public expenditures and restructuring debt, increasing fiscal space for social protection requires raising more revenues. This must entail a range of strategies including raising tax rates, reducing tax evasion and illicit financial flows and increasing foreign aid.

Strengthening capacities for domestic resource mobilization carries potential to foster sustainability and accountability of the government towards its own citizens. Tax systems differ widely in their redistributive capacity due to differences in tax composition and their individual design. Personal income taxes (PIT) have the largest redistributive capacity when rates rise progressively with income so that high earners shoulder a larger part of the burden. Social security contributions can be tied to PIT so that they, too, adhere to the principle of solidarity financing. Taxes on capital incomes, wealth or financial transactions could in principle have a highly progressive impact. In practice, however, rates are far lower than PIT in many countries which undermines principles of social justice.

As in the case of social insurance, the difficulty in LMICs is that economic structures tend to be highly informal. This is one reason for why tax systems in the Global South often depend to a much larger extent on indirect taxes such as Value Added Tax (VAT) that cannot take due account of the equity principle whereby richer individuals should not only pay larger absolute amounts into the common pool but also higher relative shares of their income and wealth. VAT taxes consumption and since the poor consume a much larger share of their income, it hurts them most – even if these resources are then used to finance progressive benefits.

Overall, the challenge of designing more progressive tax systems that align with social protection schemes in a common effort to reduce inequality and eliminate poverty is hence threefold. In the first place, more resources are needed to put in place comprehensive social protection systems. This means taxing corporations and high wealth individuals sufficiently. In the past decades, the tax burden on so-called high-net-worth individuals – and the corporations they own – has diminished continuously, not only because top marginal tax rates have decreased but also because the relevance of taxes on wealth, capital incomes and business profits are dwindling down. Secondly, there must be an end to elaborate schemes for shifting profits between jurisdictions that enable companies to avoid paying their fair share and instead shift the tax burden on labour. This global trend is one reason for why the rise in inequality has been accompanied by a decreasing share of labour in national income over the last decade – alongside declining levels of unionization and collective bargaining as well as stagnating wage levels. Thirdly, there should be recognition that it is an international responsibility to regulate international taxation and support countries to collect their fair share of taxes. Tax systems need to be more progressive in nature so that raising these extra resources contributes to reducing inequality rather than worsening it. Lastly, enforcement and compliance need to be strengthened to ensure a fair sharing of burden.

The need to strengthen tax systems in LMICs should also not divert attention away from the responsibility of the international community, where new financing mechanisms may be needed to ensure the realization of the global responsibility for social protection floors worldwide, especially in times of crises and disasters, and in countries that cannot yet finance social protection floors by their own means.

The way forward

Social protection and its progressive financing are essential pillars for achieving the SDGs, and in particular SDG 10 that aims to reduce inequality within and between countries. Building them requires concerted efforts. Certainly, there is no 'right' system that any one country should adopt. Nonetheless, the objective is clear: establishing social protection floors through equitable financing strategies is a priority in countries where these are not yet in place. Social protection needs to follow a rights-based approach. Countries that already have appropriate floors in place should aim for extending these towards building comprehensive social protection systems that not only alleviate poverty but protect against risks across the life course and provide equitable access to high quality public services.

Strategies for building such systems need to broaden contributory schemes to include people that cannot contribute (sufficiently) through own means, and integrate these with non-contributory schemes. Ideally, non-contributory schemes should aim for universality. In the light of constrained budgets and the pressing need to reduce inequality, however, targeted assistance to those in need may be an important step on the road towards achieving universality. Ultimately, social protection needs to be recognized as a human right for all not only in principle, but in implementation. In order to increase the redistributive capacity of social protection systems, financing strategies need to build and promote progressive taxation and equitable resource mobilization. This entails taxing the upper part of the distribution more both in relative and absolute terms. This especially holds for those at the very top and for ensuring that corporations pay their fair share of the burden.

Exploring international financing mechanisms beyond aid can greatly contribute to the common goal of reducing inequality within and between countries. Reducing tax evasion and avoiding excessive tax competition should be top priority on the global agenda since it requires international cooperation. Social protection budgets need to be protected in times of crises and disasters, which means that social protection spending must be adequate even during austerity periods. Further dialogue and cooperation are needed to develop global solidarity mechanisms.

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