CABINET OF MINISTERS OF THE REPUBLIC OF UZBEKISTAN | UNITED NATIONS UZBEKISTAN | JOINT SDG FUND

# Technical Briefing Note No 4
# National Strategy for Social Protection: Public Financial Management, Costing and Fiscal Space Analysis

## 1. Introduction

The interest in the implementation of social protection floors around the world became very popular in the past decades given their positive contributions to human development, social and political stability and economic growth. Despite all these outcomes, only 45% of the global population receives at least one benefit from social protection programs (Duran et al, 2019). Based on those two conditions, the relevance of social protection for overall wellbeing and the significant share of uncovered people, the Sustainable Development Goals Agenda 2030 explicitly established in target 1.3 the need to "…*implement nationally appropriate social protection systems and measures for all, including floors, and by 2030 achieve substantial coverage of the poor and the vulnerable*". As such, the target calls for the establishment of programs aimed at achieving universal coverage or at least to move towards that by 2030. Universalism is, definitely, the long-run objective.

The case of Uzbekistan is not far from this international context. Currently, the level of social protection investment in the country (6% of GDP) is low in relation to neighbor countries and mostly concentrated in social security programs, leaving social assistance initiatives with only 0.92% of GDP for the non-contributory groups. This distribution of resources promotes inequality in access with almost 50% of the population and one-third of the poor having no benefits from social protection. In addition, the sector is characterized by a high level of fragmentation with no coordinating entity that integrates all into one single vision. This may be one cause of spending inefficiency.

The decision of the Government of Uzbekistan (GoU) to formulate a new National Strategy for Social Protection (NSSP) is correct but at the same time brings a series of financial, legal and institutional challenges that reflects the complexity of the exercise. This would be particularly relevant for the Ministry of Finance (MoF), in charge of the National Strategy for Social Protection (NSSP), and the key stakeholders that would contribute to the debate. For instance, moving to universal coverage (in the understanding that universalism is group-specific) has direct implications in the level of required funding and the internal organization of the institutions that would deliver the benefits. At the same time, this implies at least four main movements in the MoF. First, it is critical to have an accurate estimation of the cost of the Strategy based on its goals and targets and the expected calendar of implementation. Second, the search for additional funding (i.e. fiscal space creation) must be linked to that costing and in line with the technical and political conditions that the country offers in this historical moment. Third, the Ministry should continue pushing forward the Public Financial Management (PFM) agenda in order to extend certain structural reforms that are required to improve the impact of social protection plans in the population. Finally, the MoF is envisioned as the key leader in both strategy formulation and implementation phases and consequently it is quite important to politically empower it to operate in a multi-actor context (Ministry of Health, Ministry of Education, Ministry for Mahalla and Family Affairs, Ministry of Employment and Labor Relations, etc) with renewed mechanisms of dialogue and coordination.

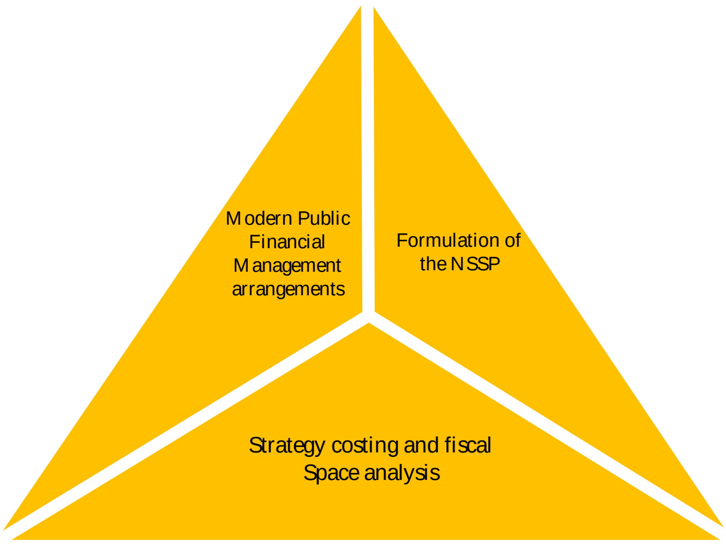
## 2. The Financing Process: from Planning to Impact

For all the actors involved in the process of formulation and definition of the NSSP, it is quite important to understand that modern public management explores financing not as a single activity focused on revenue collection but as a broader process that integrates **planning the universal social protection coverage, revenue generation and budget execution** (see figure 1). At the core of this, the NSSP may be considered the masterpiece of the process for multiple reasons. First, the strategy provides the political vision and the route that the GoU has decided for the sector in the next few years. Second, the identification of goals and targets is fundamental for costing the strategy and assess fiscal space options (i.e. new revenue generation to close the financing gap). Third, the NSSP contributes to improving PFM practices through the establishment of a programmatic framework that can be incorporated in the State Budget, the identification of annual targets that facilitates monitoring and evaluation practices, the estimation of average and total costs to be assessed vis-à-vis the Medium-Term Fiscal Policy (MTFP) and the corresponding alternatives to finance the strategy. All these aspects become highly relevant for the MoF in the context of the

“Improving the Financial Management System” strategy approved by the Cabinet in 2020 with the objectives of

> *Taking the public financial management system to a new level and further strengthening of the budget discipline, increasing the transparency of the fiscal system, enhancing the efficiency and effectiveness of the use of the State Budget, modernize methods of medium-term planning of the Republic of Uzbekistan*

**Figure 1. The three components of the financing process: macro approach**

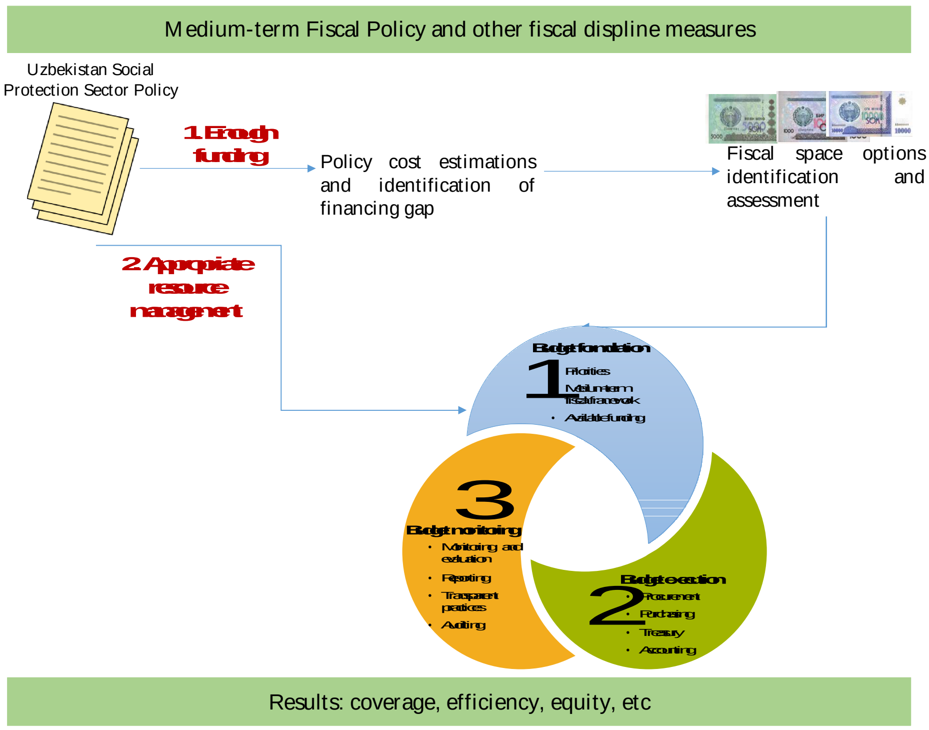



At the micro-level, the former representation can be expanded to show the links across the different components. Following Figure 2 below, there are two aspects that deserves attention for the GoU authorities and technical groups. The first one is that the financing process can be regarded as a “sandwich” bounded by an upper part (*the fiscal discipline dimension*, as set up in the MTFP) that defines budgetary ceilings for the next years and consequently delimits the scope of action of the NSSP itself while the lower part focuses on the expected and actual outcomes (*the results dimension*) achieved by the Government and other stakeholders.

Second, the formulation of the NSSP should be accompanied by two philosophical principles: 1) the generation of enough, sustained funding for the strategy, after knowing the cost of the project and 2) the application of appropriate resource management principles to orient institutional efforts towards results-based principles.

Finally, there is a complex network of relationships across planning, fiscal space creation and PFM that should not be missed. The formulation of the NSSP provides information for estimating the total cost of the strategy, the corresponding financing gap and the search for fiscal space creation. Later on, these results become inputs for the budget formulation in terms of expected revenues for social protection (fiscal space) and projected expenditures (costing exercise). Finally, there is a link moving from NSSP to budget formulation that associates the scope and characteristics of the strategy with the programmatic structure of the budget and the identification of targets for current year's performance.

**Figure 2. Links in the planning-financing-budgeting process**




## 2.1. Universal social protection

Universal coverage may be considered as the key concept in the process of formulating the NSSP as it defines a political objective and defines some fundamental inputs for the costing and the fiscal space analyses. As Rutkowski and Ortiz (2016: 8) mentions, universal social protection refers to "an integrated set of policies designed to ensure income security and support **to all** – paying particular attention to the poor and the vulnerable". This definition moves in line with the spirit embodied in SDG Target 1.3.

Although politically attractive and highly desirable for social and economic progress, shaping universalization is a complex task with direct implications in the formulation of the NSSP. For the MoF, there is a monetary dimension that cannot be avoided in a world of limited resources. There are at least three aspects of relevance:

1. **Depth of coverage, related to the scope of services: Which risks would be included in the proposed package of interventions?** Is the GoU pointing to a basic social protection floor covering all life-cycle stages or is there any room to add other social protection programs?
2. **Breadth of coverage: What is the desirable/feasible coverage rate per type of intervention?** How much is the GoU willing to advance towards universalization in each individual risk or population group?
3. **Height of coverage: Which groups will pay for social protection and how much?** What is the level of financial protection that the strategy would like to grant to the beneficiary groups? This dimension defines, in short, the characteristics of the benefits.

The three parameters, population coverage, size of the monetary benefits and total interventions included in the social protection floor, defined the core of the future costing exercise.

Finally, it may be useful to highlight that there is no single, all-encompassing model to achieve universal social protection, as the focus is on the outcomes rather than on means. ILO Recommendation No. 202 specifies that social protection floors should be nationally defined, and that countries should consider the most effective and efficient combination of benefits and schemes in their national contexts. Likewise, they should consider different methods to mobilize the necessary resources. The international evidence shows the existence of multiple paths that countries followed for universal social protection. Those experiences can be broadly structured around three type of decisions:

1. **Temporal-dimension of the implementation process**: immediate versus phased, progressive approach

2. **Legal scope of universal social protection**: constitutional/legally based mandate versus less formal provision
3. **Scope of the package:** start by universalizing one single intervention versus multiple programs at the same time

### 2.2. Costing

In a context of limited funding, the dilemma for the GoU arises from the need of establishing a balance between programs, population and size of benefits. Moving up one of them implies cutting the other(s) or, if not reduction is opted in any category, then additional resources would be required to fulfill the increasing costs. Preliminarily, the cost of the NSSP can be defined as:

$$NSSPC_t = \sum_{i=1}^{N} Pop_{i,t} * Ben_{i,t} + TAC + TKI$$

Where the NSSP cost in year t is the sum of the costs of the N interventions included in the social protection floor (population covered in that year and monetary individual benefit and), total administrative costs (TAC) and total capital investments (TKI), if necessary. The first part of the equation covers the substantial component of the strategy, that is, the cost of the social protection programs while the second and third parts refer to operation and logistic requirements (i.e. implementation). The costing exercise would require information about:

- List of interventions included in the NSSP
- Group-specific population (children, people with disability, old age, etc) by covered/uncovered status with a social protection intervention
- Size of the monetary benefit by program
- Existing network of branches in charge of delivering the services
- Existing human resources and planning parameters to estimate optimal levels
- Distribution of staffing cadres per branch
- Wage levels per category
- IT needs
- Current spending allocations per ministry, branch or similar offices in charge of benefit delivery

### 2.3. Fiscal space creation: definition and alternatives

#### 2.3.1. Concept

Fiscal space assessment is the next natural step to consider in the formulation of the NSPP after calculating the cost of the strategy and estimating the financing gap. But, what is exactly the term "fiscal space"?

An intense debate has emerged during the past 15 years regarding the definition and scope of fiscal space. Perhaps the most well-known definition was contributed by Heller (2005: 3) who established fiscal space as "*the availability of budgetary room that allows a government to provide resources for a desired purpose without any prejudice to the sustainability of a government's financial position*." This traditional approach basically defines fiscal space as a *room* that governments have to expand outlays but bounded to the limits of debt sustainability.

Diverse authors (Roy and Heuty, 2009; Perotti, 2007 and Aguzzoni, 2011) cast doubts about the convenience of using terms like *gap* and *room* because they give the idea that fiscal space is a residual, passive process with a limited available amount of resources bounded by the existing deficit and debt outcomes. Under this vision, the creation of fiscal space would be restricted to enhanced efficiency, budget redistribution and increased indebtedness until certain point. Roy and Heuty (2009: 33), on the contrary, proposes a new concept in terms of:

> *"…[f]iscal space is the financing that is available to government as a result of concrete policy actions for enhancing resource mobilization, and the reforms necessary to secure the enabling governance, institutional and economic environment for these policy actions to be effective, for a specified set of development objectives."*

In this regard, and jointly with Ortiz et al (2019: 9), fiscal space should be regarded as an "active exploration and utilization of all possible revenue sources…" as well as the measures at the legal and institutional realms to make those options effective. This new conception introduces at least three changes to the traditional view. First, the creation of fiscal space should have an attached label, that is, it must be fiscal space for social protection in this case. Second, the creation of fiscal space is a dynamic process in which government can actively search for additional sources from other sources beyond budget redistribution or debt. Third, fiscal space creation implies both new funding and institutional transformations. In particular, the introduction of expenditure management arrangements is critical to maximize the eventual impact of the new resources on the population.

### 2.3.2. Options to create or expand fiscal space for social protection

The SDG-2030 Agenda establishes financing as one of the transversal topics for the success of the strategy. Specifically, the Agenda states in Target 1a that the efforts should

> *Ensure significant mobilization of resources from a variety of sources, including through enhanced development cooperation, in order to provide adequate and predictable means for developing countries, in particular least developed countries, to implement programmes and policies to end poverty in all its dimensions*

This target is complemented by SDG Indicator 1.a.2 that measures the proportion of total government spending on essential services like education, health and social protection. Multiple authors have debated about the different alternatives for financing the SDG strategy with discussions focusing around three topics: the role of domestic versus external financing; the participation of private funding versus the sufficiency of public money and the use of traditional versus non-traditional sources (UN Secretary-General, 2018). Although multiple experiences combine general recommendations with sector-specific strategies, there is some consensus that countries: a) should not rely heavily on Official Development Assistance; b) should promote private financing and the new financial models that emerged in the past years (Impact Investments, Social Bonds, etc) and c) should pay attention to those mechanisms that improve the capabilities of stakeholders and key actors to deliver the required benefits to the target populations. This includes modernizing institutional arrangements like planning, budgeting, and monitoring and evaluation practices, all addressed to performance-oriented foundations.

For the specific case of **social protection**, Ortiz et al (idem, 2019) identified 8 potential sources of fiscal space alternatives. This list comprises a mix of options that combine domestic and external sources, traditional and non-traditional and revenues-based and expenditure-based possibilities. The list includes:

1. **Expanding social security coverage and contributory revenues**: this option may take the form of increasing contributory rates, expanded coverage (salaried and independent workers) or a mix of both
2. **Increasing tax revenue**: as in the previous case, fiscal space can be created by expanding the base, increasing existing rates, approving new taxes, reducing tax expenditures (exemptions) and reducing evasion
3. **Eliminating illicit financial flows**: this alternative includes an estimation of flow going out the county in terms of money laundering, bribery, tax evasion, trade mis-invoicing and other financial crimes.
4. **Re-allocating public expenditures**: this alternative does not create new funding, but it basically promotes moving resources from one sector to another or improving the internal level of efficiency of the social sector. These may include replacing high-cost, low-impact investments with those with larger socioeconomic impacts, eliminating spending inefficiencies and/or tackling corruption.
5. **Using fiscal and central bank foreign exchange reserves**: this includes drawing down fiscal savings and other state revenues stored in special funds, such as sovereign wealth funds, and/ or using excess foreign exchange reserves in the central bank for domestic and regional development.
6. **Managing debt – borrowing or restructuring sovereign debt**: this involves an active exploration of domestic and foreign borrowing options at low cost, including concessional loans, following a careful assessment of debt sustainability. Other options include restructuring existing debt
7. **Adopting a more accommodating macroeconomic framework**: this option aims at promoting a new macroeconomic approach that allows for more flexible policies in terms of inflation goals and public deficits without jeopardizing the overall macro sustainability
8. **Increasing aid and transfers**: these transfers refer to flow of funds coming from international agencies, governments and other entities for developmental purposes.

The adequacy of each option depends on many factors including the political circumstances of the country, the historical participation of social security in the sector financing, the period since the last tax reform and the system of ideas governing the Cabinet, among others. For instance, recent fiscal reforms may limit the possibility of introducing a new tax or to increase the existing rates, reducing in this way the possibility of opting for that alternative. Also, in countries like Uzbekistan where non-contributory programs account for a small share of the total social protection financing, the Government may decide for sources that rely on consumption or income taxes instead of social contributions. Promoting non-traditional sources like illicit flows reduction can be a valuable source of funding. According to the Global Financial Integrity (2020), illicit trade flows in Uzbekistan totalized US$467 million in 2017. In other cases, due to political demands, the package of alternatives may combine increased taxation with expenditure-based measures.

### 2.4. Modernizing the PFM

Enhancing the level of available resources for social protection is of paramount importance for the success of the NSSP but more actions will be needed to improve the capacity of the stakeholders to allocate and use those funds. If properly designed, these efforts should be oriented to introduce changes at three levels: **budget formulation, budget execution and budget monitoring** (Cashin et al, 2017). Changes in the budget formulation include improvements in the quality of the MTFP (better projections and stronger planning-resources link) and the introduction/deepening of program-based budgeting (performance-oriented budgeting). When taking about budget execution, the agenda would concentrate on improved Treasury practices and modern procurement systems, among others. Finally, budget monitoring is related with internal and external follow-up, reporting and auditing actions. The implementation of regular evaluations studies should be institutionalized as part of the studies to improve overall spending management.

The most recent 2018 Public Expenditure and Financial Accountability (PEFA) assessment in Uzbekistan recognizes advances in the modernization of the PFM system but at the same time raises some concerns about the overall model in place. The assessment positively evaluates the existence of strong monitoring mechanisms for budgetary control and fiscal stability although in general terms there is also the opinion that the public internal control framework, managed through the MoF, is excessive and mostly control and inspection dominated, with a heavy reliance on a culture of punishment. In addition, weak controls exist, however, in tracking results and the efficiency/effectiveness of service delivery, a clear indication that the country is more interest in follow-up inputs (revenues and expenditures) than outcomes. In short, the Uzbek public institutions with budget responsibilities do not apply international good practices in the PFM. The budget preparation process managed by the MoF does not apply a multi-year framework and is not informed by sector strategies. The oversight (MoF, Ministry of Economic Development and Poverty Reduction, Ministry of Employment and Labor Relations) and line agencies involved in public investment management (PIM) do not have adequate capacity to identify, develop, appraise, execute, and monitor public investment projects.

In a second place, there is also a recognition that overall fiscal discipline is good in Uzbekistan but some improvements should be adopted in terms of risk analysis and the existence of a public debt strategy, the putting in place of some internal controls of the budgetary execution and the expansion of monitoring activities to a broader share of the public sector.

Third, the iinstitutionalized internal and external accountability and transparency of PFM systems are weak. Regarding budget execution reporting, financial information is detailed and consistent. However, the government financial statements are neither consolidated nor do they have disclosures on accounting policies and other information required by international accounting standards (e.g., contingent liabilities). The Annual Financial Reports are de facto a budget execution report. There is no clear legal framework, nor comprehensive national public sector accounting standards. Public sector accounting and reporting expertise and knowledge is inadequate. Current internal audit practices do not adhere to international good practices on the role of the internal audit and there is little, or no internal audit focused on systems monitoring. The focus is on detecting formal violations, recommending corrective actions, and levying penalties, instead of analysing systemic issues (e.g., evaluation of business processes, effectiveness of internal control frameworks, governance and risk management). Overall, these approaches heavily emphasise compliance over performance, and thus are not consistent with modern public sector management practices. Accordingly, the PFM system does not adequately contribute to accountability of institutions and individuals for results in social protection.

It is in this context and set of challenges that the GoU recently adopted the 2018-2028 PFM reforms with the objective of “improving the efficiency and effectiveness of the Government of Uzbekistan, through the introduction of program budgeting and its use to improve the quality of services provided" (PEFA, 2020: 11). The main areas of interest of this new PFM program include:

- development of the medium-term budget framework for the implementation of a strategic approach to fiscal policy and the introduction of a new system of "results-oriented budget" for the formation of the annual budget;
- increase institutional capacity and accountability of participants in the budget process to ensure the reliability of macro-fiscal forecasts;
- increase the powers and accountability of budget allocators and local authorities in the budget sphere
- fiscal risk assessment, financial assets and accounting for obligations and establishing an effective management system for them;
- unification of budget accounting standards, internal control and strengthening financial discipline by improving the audit system;
- ensuring transparency, completeness and compliance of budget data with international standards;
- strengthening parliamentary and public oversight of the budget process.

A key aspect to note is that the concurrent formulation of the NSSP and the PFM reform creates a propitious moment for linking them and prepares a series of activities "to pilot-test" the transformation of the PFM with the conditions established in the social protection strategy. For instance, given that one of the focus of change is program budgeting, the NSSP provides different motivations (type of target population, goals, etc) to design those programs under the umbrella of performance-based budgeting.

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