

# BRIEF on Alternatives to Austerity:

## Fiscal Space and Financing Options for a People's Recovery

BRIEF based on *"End Austerity: A Global Report on Budget Cuts and Harmful Social Reforms in 2022-25"* by I. Ortiz and M. Cummins

**Some argue that austerity cuts are an unavoidable necessity. This is not the case. This brief presents nine alternatives to prevent a post-pandemic austerity shock, so that governments and citizens can end austerity.** Decisions about expenditure allocations, budget cuts and financing sources affect the lives of millions of people and cannot be taken behind closed doors by a few technocrats in the Ministries of Finance and staff from IMF and the World Bank, but require national social dialogue. For this, see the companion pieces *"Brief on What Citizens Can Do to End Austerity?"* and *"Brief on Budget Cuts and Austerity Reforms in 2022-25"* ([link](#)).

**Austerity is not inevitable; there are alternatives, even in the poorest countries.** There is no need for populations to endure adjustment cuts: instead of cutting public expenditures, governments can increase revenues to finance a people's recovery. There is a wide variety of options to expand fiscal space and generate resources. These options are supported by the UN (see for instance, [ILO, UNICEF and UNWOMEN](#) and [ILO and UNWOMEN](#)) as well as the IMF, OECD and others. Many governments around the world have been applying most of them for decades, showing a wide variety of revenue choices. It is important to understand is that, while fiscal space becomes strained during economic downturns, public budgets are limited in many countries because governments did not explore all possible financing sources. And while it is promising that some of these options have emerged in recent policy discussions, much more ambition is needed to effectively provide countries with the funding required to emerge from the COVID-19 pandemic and deliver on the Sustainable Development Goals ([SDGs](#)).

**A fundamental human rights principle is that States must utilize the maximum amount of resources to realize human rights. The main options to avoid austerity and instead finance human rights and the SDGs are:**

- 1. Increasing progressive tax revenues:** This is the principal channel for generating resources, which is achieved by altering tax rates —e.g. on corporate profits, financial activities, wealth, property, imports/exports, natural resources, digital services or ending 'special economic zones' and other tax exemptions/breaks to big corporations. Given the increasing levels of inequality, it is important to adopt progressive approaches, taxing those with more income; consumption taxes should be avoided as they are generally regressive and hamper social progress. It is recommended to implement a minimum corporate tax rate of at least 25%, in line with the proposal from the UN Financial Accountability, Transparency and Integrity (FACTI) Panel. It is important to strengthen the efficiency of tax collection methods and of overall compliance, including fighting international tax dodging, corporate tax avoidance and evasion. Many governments are increasing taxes to achieve greater social investment. For example, Bolivia, Mongolia and Zambia are financing universal pensions, child benefits and other schemes from mining and gas taxes; Ghana, Liberia and the Maldives have introduced taxes on tourism to support social programs; Belgium, Canada, France, India, Indonesia, Kenya, New Zealand, Tunisia and Türkiye on digital services; Algeria, Angola, Australia, Canada, Kazakhstan, Italy, Mauritania, Mozambique, Norway, Papua New Guinea, Russia, Saudi Arabia and the United Kingdom are taxing windfall profits in the energy sector; Hungary and Spain are introducing taxes to banks for windfall profits; Argentina and Brazil introduced a tax on financial transactions to expand social protection coverage. Argentina, Iceland and Spain have implemented wealth taxes; encouragingly, wealth and corporate windfall taxes are being proposed in many countries as a best policy for post-pandemic recovery (see [EURODAD](#) , [OXFAM](#) and [GATJ](#)).
- 2. Restructuring or eliminating debt:** For the majority of countries that are indebted, in particular those in high debt distress, reducing or eliminating existing debt may be possible and justifiable if the legitimacy of the debt is questionable and/or the opportunity cost in terms of worsening deprivations of the population is high —when debt service repayments derail human rights and development. As former President Julius Nyerere of Tanzania demanded

publicly during the 1980s debt crisis, "*Must we starve our children to pay our debts?*" The concept of illegitimate debt looks at responsibility of not only debtors but also creditors.<sup>1</sup> Citizens Public Debt Audits are very useful tools for transparency and debt action that can lead to the cancellation or repudiation of illegitimate debts.<sup>2</sup> There are five main options available to governments to reduce or eliminate sovereign debt: (i) debt relief/cancellation; (ii) re-negotiating debt; (iii) debt swaps/conversions; (iv) repudiating debt; and (v) defaulting. In recent years, over 60 countries have successfully re-negotiated debts, over 50 have implemented debt swaps and more than 20 have defaulted or repudiated public debt, such as Ecuador, Iceland and Iraq, which invested debt service savings in social programs. A fair and transparent arbitration process between debtors and creditors is needed, an international debt work-out mechanism. Since COVID-19, the G20's Debt Service Suspension Initiative (DSSI) and the IMF's Catastrophe Containment and Relief Trust (CCRT) have provided some temporary debt service relief to highly indebted poor countries; this is a step in the right direction, but more and better debt relief is needed (see [EURODAD](#), the [Spotlight report](#) and [BWP](#))

3. **Eradicating illicit financial flows:** Estimated at more than ten times the size of all development aid received, a titanic amount of financial resources illegally escapes developing countries each year. To date, little progress has been achieved, but policymakers should devote greater attention to cracking down on money laundering, bribery, tax evasion, trade mispricing, and other financial crimes that are both illegal and deprive governments of revenues needed for social and economic development (see [FTC](#) and [GFI](#)).
4. **Increasing social security contributions and coverage, including adequate employers contributions and formalizing workers in the informal economy with decent contracts:** For social protection, increasing social security employers' contributions to adequate levels, and expanding coverage and therefore the collection of new contributions are sustainable ways to finance social protection that help to formalize and protect workers in the informal economy, providing them with contracts with decent work conditions; examples can be found in the *Monotax* in Argentina, Brazil and Uruguay. This is particularly important for women to enter the labor force and attain formal employment (see [ILO](#)).
5. **Using fiscal and central bank foreign exchange reserves:** Most countries have large reserves sitting in the central bank or special funds, when they could be used to fund human rights and development today. Specifically, this option includes drawing down fiscal savings and other state revenues stored in special funds such as sovereign wealth funds (SWFs), and/or using excess foreign exchange reserves accumulated in the central bank for domestic and regional development, for example, through national development banks (see [Bread for the World](#)). SWFs are state-owned investment funds, which in theory are established to serve objectives such as stabilization funds, savings or pension reserve funds; however, many question the logic of using public funds for capital market growth, often investing overseas in the stock exchanges of Wall Street, London or Tokyo, instead of prioritizing public programs at home. With respect to keeping mass amount of foreign exchange reserves sitting at the Central Bank, there is an accepted safe level of reserves equivalent to 3 months of imports, but most governments have accumulated a vast arsenal as a precautionary policy of self-insure against shocks, when those resources could be invested in much needed social and economic development today.
6. **Re-allocating public expenditures:** This involves adjusting budget priorities and/or replacing high-cost, low social impact investments such as defense or corporate subsidies, with those with larger social impacts. Savings can also be achieved by improving procurement processes, including steps to tackle and prevent corruption and the mismanagement of public funds. For example, Thailand reduced spending on the military in order to fund universal health services and Costa Rica abolished its army and used the funds for environment, health, education (see [Wemos](#)).

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<sup>1</sup> The concept of illegitimate debt refers to a variety of debts that may be questioned, including: debt incurred by authoritarian regimes; debt that cannot be serviced without threatening the realization or non-regression of basic human rights; debt incurred under predatory repayment terms, including usurious interest rates; debt converted from private (commercial) to public debt under pressure to bail out creditors; loans used for morally reprehensible purposes, such as the financing of a suppressive regime; and debt resulting from irresponsible projects that failed to serve development objectives or caused harm to the people or the environment (UN, 2009; EURODAD, 2009).

<sup>2</sup> Christian Aid (2007) outlines a number of practical steps that debtor countries can follow to determine if debt repudiation is a sensible option: (i) assess the impact that debt servicing has on the financing of basic services; (ii) carry out a full citizens' debt audit to identify which parts are odious or illegitimate; (iii) identify what portion of the legitimate debt can be serviced without jeopardizing essential public services; (iv) hold a moratorium on servicing illegitimate debt and discuss with creditors; (v) depending on the progress of discussions, examine the possibility of withholding payments in order to increase investments in basic services; and (vi) open debt contraction processes to national dialogue and full democratic scrutiny.

7. **Adopting a more accommodating macroeconomic framework:** This entails allowing for higher budget deficit paths and/or higher levels of inflation without jeopardizing macroeconomic stability, thus allowing the central bank to support government expenditure. A significant number of developing countries have used deficit spending and more accommodative macroeconomic frameworks during the global financial and economic crisis to attend to pressing demands at a time of low growth and to support socio-economic recovery. In high income countries, many governments used quantitative easing, a monetary policy whereby a central bank purchases government bonds or other financial assets in order to inject money into the economy to expand economic activity, though it highly benefited financial corporations and more equitable policies are a preferable option. These measures have also been a common response in the early phase of the COVID-19 response (see [ActionAid](#) manual).
8. **Lobbying for ODA and transfers:** The last two options are international and require bilateral or multilateral agreements. In this case, it requires engaging with different donor governments, international financial institutions and regional organizations to ramp up North-South, South-South or regional transfers, preferably through grants and concessional loans. However, this option is limited given many pitfalls of ODA, including its low levels, transaction costs, limited predictability, tied aid, concentration, conditionality and, recently, that ODA is often used for in country refugee costs (and in the future for the reconstruction of Ukraine) displacing support to developing countries (see [BWP](#), [EURODAD](#) and [Arab Watch Coalition](#)).
9. **Special Drawing Rights (SDRs):** To address countries' development financing needs, SDR allocations are an option gaining more attention. SDRs are a kind of money created by fiat through the IFIs.<sup>3</sup> There was an extraordinary SDR allocation of US\$650 billion implemented in August 2021 during the COVID-19 pandemic for all countries. The injection of these assets by the IMF could be used by governments to shore up their reserves and stabilize their currencies, pay down debt and/or support the national budget, including for social or economic policies. However, the mechanism that the IMF has established to do this has received criticism as it turns SDRs from an international reserve asset (which can be converted to hard currency, not a loan increasing debt) into IMF loans/programs that must be repaid and have IMF conditions attached to them. Additionally, with about two thirds (US\$420 billion) of the new allocation going to developed economies, there is an urgent need to channel SDRs to developing countries, not one time, but periodically to ensure that these resources are made available for the chronic lack of development. It is essential to ensure a better mechanism that does not increase debt and conditionalities as well as a fairer and periodic distribution of SDRs (see [OXFAM](#) and [CEPR](#)).

**Each country is unique, and all options should be carefully examined, including the potential risks and trade-offs.** As a first step, it is important to identify which funding possibilities may or may not be feasible in the short and medium term. As shown in the table below, most countries combine multiple options. Governments normally start enhancing fiscal space by carving-up a bit from each feasible option, and then increasing their actions in later years.

#### Examples of fiscal space financing strategies adopted in selected countries

	Bolivia	Botswana	Brazil	Costa Rica	Lesotho	Iceland	Namibia	S. Africa	Thailand
Re-allocating public expenditures				X	X	X		X	X
Increasing tax revenues	X	X	X		X	X	X		X
Expanding social security contributions			X	X	X		X	X	X
Reducing debt/debt service	X	X	X	X	X	X		X	X
Curtailing illicit financial flows						X			
Increasing aid							X		
Tapping into fiscal reserves	X	X	X						
More accommodative macro framework	X		X						X

Source: Ortiz et al, 2019. [Fiscal space for social protection. A handbook for assessing financing options](#). Geneva and New York: ILO and UNWOMEN.

<sup>3</sup> There have also been proposals to finance the UN or regional organizations with SDRs and, in turn, the UN or regional organizations (instead of the IFIs) could finance developing countries to implement the SDGs.

**The political feasibility of these options depends on, among others, political will, citizen awareness of their rights and entitlements, political pressures, and the behavior of vested interest groups—both domestic and external.** For example, the expansion of social security coverage by formalizing those in the informal economy tends to be welcomed politically; however, increasing social security contribution rates may face resistance from employer groups. Similarly, raising revenues through higher tax rates may face challenges from those who have to pay more, just as proposals to reallocate the government budget away from defense or energy subsidies will be opposed by the military and energy corporations. On the other hand, using fiscal and central bank reserves and issuing government debt (bonds) are relatively less contentious options since they are under the sole discretion of most governments, unless fiscal restrictions were in place. Ultimately, successfully creating fiscal space requires understanding the winners and losers of a specific option and effectively debating the pros and cons in publicly in national social dialogue.

**Fiscal decisions affect the lives of millions of people must not be taken behind closed doors, but in national social dialogue.** The decisions to inflict cuts to public expenditures are taken by a few technocrats at the Ministries of Finance, with the support of the IMF and without any serious assessment of the policies' social impacts, without any national consultation or discussion of alternative policy options. These decisions affect most citizens and must not be taken behind closed doors but agreed transparently in national social dialogue. It means that governments must negotiate agreements transparently with input from a range of stakeholders including representative trade unions, employer federations and CSOs, as part of good governance.

**It is essential to explore all financing options to ensure a people's recovery.** What is important to understand is that, while fiscal space becomes strained during economic downturns, public budgets are limited in many countries because governments have not explored all possible financing sources. Today, at a time of austerity and crisis, the need to create fiscal space has never been greater. It is imperative that governments aggressively explore all possible financing alternatives to promote post-pandemic recovery, realize human rights and achieve the SDGs.

This brief is based on ***"End Austerity: A Global Report on Budget Cuts and Harmful Social Reforms in 2022-25"*** ©Isabel Ortiz and Matthew Cummins. Published by ActionAid, Arab Watch Coalition (AWC), Eurodad, Financial Transparency Coalition (FTC), Global Social Justice, International Trade Union Confederation (ITUC), Latindadd, Public Services International (PSI), The Bretton Woods Project, Third World Network (TWN) and Wemos.

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