FINANCING SOCIAL PROTECTION

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September 2004

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1 Introduction

This paper was commissioned as a one of a set of brief papers providing background materials to support a DFID policy document on social protection. It considers the opportunities, constraints, and options available to a bilateral donor in the financing of social protection.

There are different sources of financing for social protection, including aid from international donors; public expenditure by national governments; private, community, and NGO financing; and household saving and out of pocket expenditures. This paper covers the first two sources only.

The paper is divided into four sections. The first section provides a brief description of social protection; the second section considers national government's support for social protection; the third section considers international organisations' support from social protection; and the last section reviews the key issues.

2 What is social protection and why does it matter?

There is a consensus emerging among international organisations and national governments in developing countries that social protection provides an effective framework for addressing rising poverty and vulnerability in the global economy. Social protection can be defined as all interventions from public, private, voluntary organisations and informal networks, to support communities, households and individuals, in their efforts to prevent, manage, and overcome a defined set of risks and vulnerabilities.1

Social protection developed as a response to rising poverty and vulnerability in the 1980s and 1990s (Latin American crises, the Asian financial crisis, the process of transition, and economic stagnation in Africa). It is often said that globalisation brings both greater vulnerability and increased opportunity. Social protection mitigates the vulnerabilities but also facilitates the capture of the opportunities. It involves a wider range of instruments and stakeholders than do social assistance, safety nets, or social insurance.

Social protection can be seen as an extension of anti-poverty policy. It is grounded in the view that vulnerability, i.e. the limited capacity of some communities and households to protect themselves against contingencies threatening their living standards, is a primary factor explaining their poverty and low levels of investment, insufficient to enable them to take advantage of economic and social opportunities for advancement.2

Social protection should be located within growth and development policy. Well designed social protection interventions support consumption and investment, and can therefore make a measurable contribution to growth and development (see Box 1).

Social protection contributes to growth and development in a number of ways:

1. it helps correct market failures that contribute to poverty, for example absent or imperfect credit and insurance markets;
2. it facilitates investment in human and physical assets which can alone reduce the risk of future poverty, e.g. support for education or micro-enterprise;
3. it reduces behavioural responses to vulnerability, like postponing healthcare or switching to poor quality foods, which are understandable in the context of the situation of vulnerable households but restrict growth and development in the medium and long term;
4. it reduces incentives for unproductive and antisocial behaviour;
5. by providing strong safety nets and fostering social cohesion, social protection also facilitates positive social and economic change and reduces the likelihood of conflict.

Box 1 Progresa and Oportunidades

Progresa (Programa Nacional de Educación, Salud y Alimentación), introduced in Mexico in 1997, supports poor rural households with children through a cash benefit to support household consumption conditional on regular visits to health centres, plus cash benefits for children of school age conditional on attendance. The programme uses geographic, community, and household targeting, reaching 40% of rural households at a cost of 0.32% of GDP. Early evaluation shows good outcomes, and has led to the programme being extended to urban areas in 2003 as Oportunidades.

Source: Coady (2003)

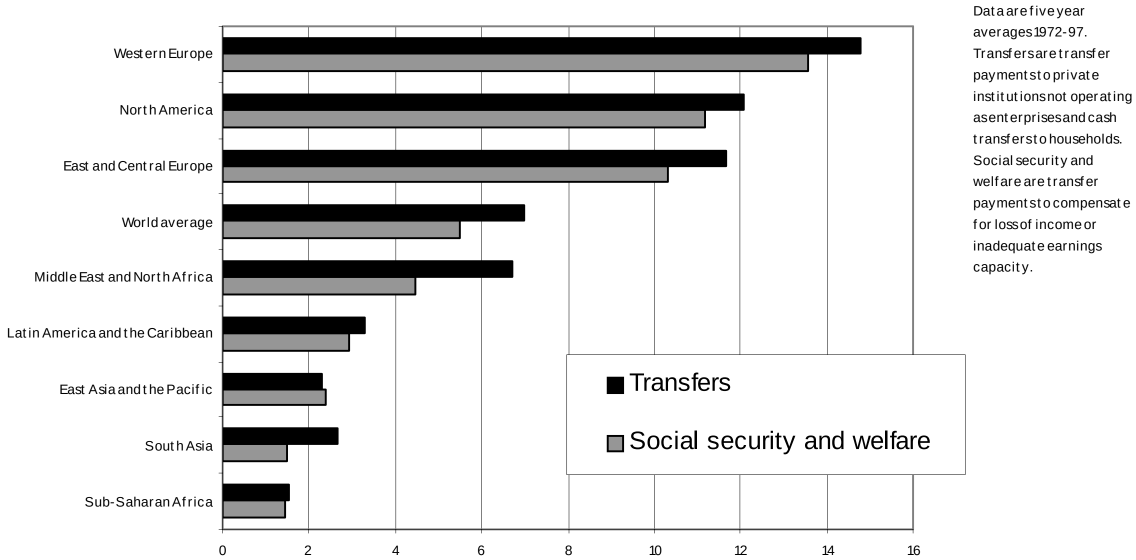
3 Government financing of social protection

National governments can support social protection through macroeconomic policy, public expenditure, tax policy, and regulation. There are significant gains from the coordination of macroeconomic policy and social protection. Macroeconomic policies that ensure sustainable growth and fiscal stability are important in reducing vulnerability and in securing the resources needed for social protection. Effective social protection can also help achieve macroeconomic goals by contributing to an adaptable economy capable of taking advantage of the opportunities from globalisation. Given the distributional impact of macroeconomic crises,[3] macroeconomic policy should aim to prevent crises and mitigate the impacts of these on the poor and vulnerable. An important issue here is the pro-cyclical nature of public expenditure in developing countries. There is a need to develop capacity for an autonomous fiscal policy that could mitigate the impact of external shocks.[4] Within public expenditure, social protection is consistent with strengthening automatic stabilisers, such as workfare programmes, targeted human development programmes, and other transfers to the poor and vulnerable.[5]

Public expenditures on basic and social services are in the main directed towards social protection.[6] Tax policy supports social protection through the revenue collection that finances public expenditure on social protection, but also can support social protection directly through tax expenditures, for example through tax exemptions applied to private and social insurance contributions. Regulation covers a wide area: labour standards, employee benefits, financial regulation and access, and price regulation (utilities, foodstuff, merit goods, etc.). Key issues include whether public expenditure on social protection is adequate and effective, the limited tax base of developing countries, and distortionary effects of taxation and regulation.

Are governments spending enough on social protection? This is a hard question to answer, as there is insufficient guidance from theory as to what would be an optimal level of expenditure on social protection.[7] Taking a positive approach and examining current levels of expenditure across countries and regions suggests a number of stylised facts. There is considerable global, regional, and intra-regional variation (see Figure 1 below)[8]. Broadly, there is a positive association existing between economic development and public expenditure on social protection. Political economy factors are important in explaining demand for social protection expenditures, but revenue collection capacity is a key factor explaining supply. Among low and middle income countries, donors play an important role in financing social protection expenditure and in setting the priorities for policy (Smith and Subbarao, 2003).

Figure 1 Public expenditure on social protection as % of GDP by region



Source: Besley *et al.* (2003) from IMF data.

Besley *et al*. (2003) have carried out a benchmarking for a large number of developed and developing countries. Using data on social security and welfare expenditure averaged over 1972–97, first they rank countries according to the level of their expenditures on social protection (as a percentage of GDP). The first column in Table 1 below shows the rankings for sub-Saharan Africa. The countries are bunched very closely together. An interesting feature of this research is that the authors attempt to account for the impact of structural factors (the level of development, demographics and shocks) and the quality of institutions (the rule of law, contract enforcement, corruption, etc.). This allows them to identify government effort in social protection spending. Governments might be expected to spend more on social protection than other governments if they have reached a higher level of development, or are more exposed to adverse shocks. Similarly, governments can afford to spend less on social protection than other governments if their institutions are stronger and more effective than other countries. The rankings for the second and third column are based on the unexplained component of social protection expenditures after controlling for structural and institutional factors respectively. These now move in different directions. Countries that improve their rankings can be said to be spending more than expected given their structural and institutional constraints; countries that show deteriorating rankings spend less than expected taking into account these factors. Ethiopia improves its ranking significantly owing to the adverse shocks suffered in the period. The rankings for South Africa, on the other hand, move down after controlling for structural and institutional factors. An important finding of the study is that the raw level of expenditure on social protection may not tell us very much about a country's social protection effort, or about the demand for social protection.

Table 1 Measuring the social protection effort

Country	Ranking using level of social security expenditure	…now controlling for structural factors (level of development, shocks, demographics)	…now controlling for institutional factors (rule of law, corruption, etc.)
Togo	46	25	21
South Africa	51	66	64
Ethiopia	53	9	7
Zimbabwe	54	42	48
Senegal	55	40	31
Cameroon	56	48	53
Mali	58	27	19
Burkina Faso	60	26	44
Côte d'Ivoire	61	46	41
Republic of Congo	62	57	58
Guinea-Bissau	63	21	23
Madagascar	65	32	26
Gambia	69	29	25
Niger	73	30	20
Dem. Rep of Congo	74	31	34

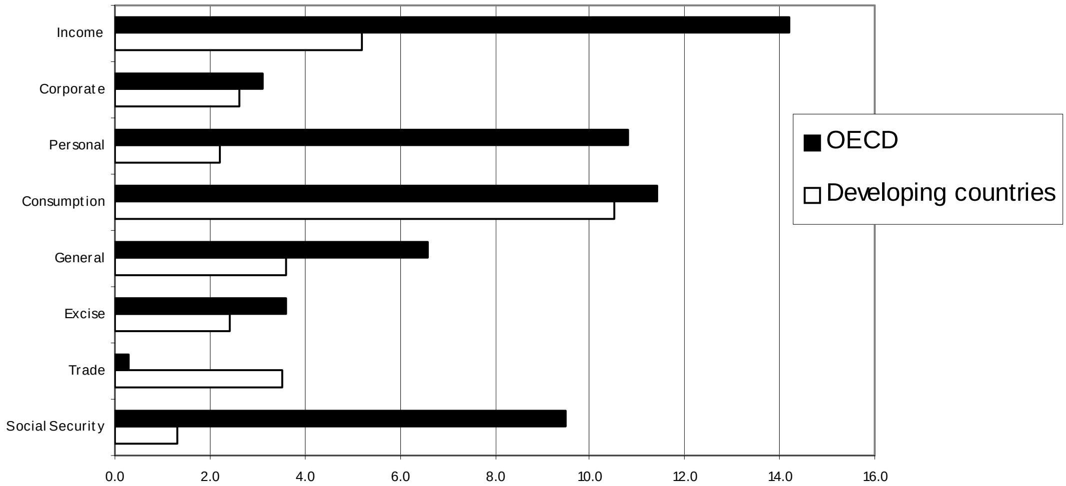
Source: Besley *et al.* (2003), first ranking uses averaged social security and welfare expenditure 1972–97. Data from IMF, social security and welfare defined as transfer payments to compensate for loss of income or inadequate earning capacity.

Can developing countries raise their social protection spending levels? Affordability is an important issue for most developing countries. Raising expenditure levels on social protection financed from domestic sources would involve redirecting funds from other areas of expenditure or improving revenue raising capacity. For low-income countries with under-performing economies, these are difficult to achieve.

There is scope for shifting expenditure from other areas towards social protection, but there are also practical obstacles to this shift. The timeframe for shifts in public expenditure is usually a long one, making this at best a medium term objective.[9] The political economy literature on public sector reform suggests shifting public expenditure will be more difficult the greater the number of losers, and the more upfront the losses are. Among developed countries, raising public expenditure on social protection has been achieved by shifting the composition of tax revenues towards income, especially payroll, taxes.

Constraints on the capacity of developing countries to raise revenue limit public expenditure, and therefore expenditure on social protection. These constraints are associated with the structure of the economy (extent of the rural subsistence economy and the informal sector), but also administrative capacity. For the period 1995–97, tax revenue was 37.9% of GDP among developed countries, but only 18.2% in a sample of developing countries (Tanzi and Zee, 2000). There are also differences in the composition of the tax revenues. Developing countries rely to a larger extent on consumption and trade taxes, whereas developed countries are able to finance their social protection programmes with income and particularly payroll taxes. See Figure 2 for a comparison of the composition of tax revenue for developed and developing countries.

Figure 2 Composition of tax revenue 1995–97 (% of GDP)



Source: data from Tanzi and Zee (2000).

Many developing countries are considering introducing social health insurance as a means of financing rising healthcare expenditures. This provides a very good example of the issues involved in financing an expansion of social protection through payroll taxes. Social health insurance could finance improved healthcare, with additional off-budget income taxes rather than budget reallocations, and could integrate out-of-pocket expenditures on health prevention and care more easily within the financing mix (where insurance finances a fraction of expenditure, for example). It can also help to control health expenditures, through co-payments or co-insurance. It will therefore have a corrective effect on common insurance market imperfections. Gertler discusses these issues in the context of the experience of Asian countries, and concludes that the 'most important lesson is that … countries achieved successful implementation only when they were at a relatively high level of income, were largely urbanised, and had large wage sectors relative to informal sectors' (1998). By implication, financing an expansion of social protection through payroll taxation is a policy option for middle and high-income countries.

Potential distortionary effects of (payroll) taxation need not be exaggerated. Concerns over whether this will exacerbate market distortions in developing countries need to be balanced with the fact that the excess burden of taxation is lower there (because it is broadly proportional to the level of tax revenues as a proportion of GDP), and markedly lower for income taxes.[10] And to the extent that social insurance provides valued benefits to those covered, higher rates of personal taxation are not an insurmountable problem.[11] The perceived benefits from improved social protection, especially in the context of missing insurance markets, could generate conditions for a 'double dividend'.[12]

The options for low and very low income countries wishing to expand social protection are very limited, and external finance is crucial.

Government support for social protection can also operate through tax expenditures and regulation. With the exception of regulations on labour standards, these are significantly under-researched in the context of developing countries. Tax expenditures can be important in middle and high-income developing countries and are, as a rule, highly regressive. In South Africa, tax exemptions to private pension plans have been estimated to reduce revenues by an annual 1.7% of GDP (Barrientos and Lloyd-Sherlock, 2003). Tax exemptions on foodstuff, school materials, agricultural tools, etc. are very common in developing countries. They tend to show large leakages to the non-poor while at the same time diminishing the tax base.

Globalisation is set further to reduce the revenue-raising capacity of developing countries, through the impacts of growing e-commerce, labour migration, and trade and financial liberalisation (Tanzi, 2000). To the extent that globalisation encourages trade and economic growth, it can have a positive effect on the level of tax revenues, especially given the reliance of developing countries on taxes on trade.

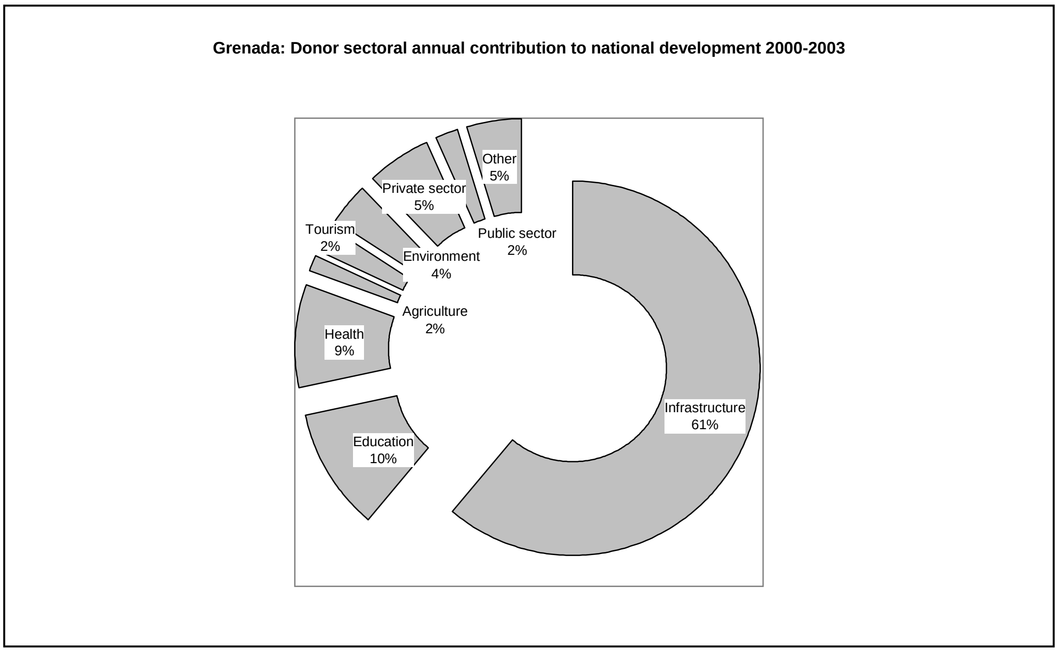
Is there political support for extending social protection? Political economy factors are important in explaining public financing of social protection. Public choice models suggest that social protection targeted at the vulnerable may be more politically acceptable than support targeted at the current poor. In the context of developing countries, where, in addition to the poor, large sections of the non-poor are also vulnerable, social protection will naturally enjoy wider support.[13] Public choice models assume political leaders are directly responsive to the electorate, but this may not be representative of the political environment in many developing countries. A less precise but perhaps more informative framework for assessing political support for social protection considers a country's 'social contract'. As Graham suggests, the extension of social protection 'ultimately requires the development of a politically sustainable social contract' (2002). Countries that have expanded publicly financed social protection in the last two decades, such as Brazil, have achieved this on the basis of a renewal of the social contract.

4 International organisations' financing of social protection

Social protection has been located traditionally within the jurisdiction of the International Labour Organisation. The ILO has been largely responsible for the development of social protection instruments and institutions in the developing world (Usui, 1994). The extension of the scope of social protection in the 1990s has meant that a number of other multilateral organisations that finance development programmes are also involved in social protection, e.g. the World Bank, UNDP, WHO, UNICEF, and others. In addition, regional organisations have developed and adopted social protection policy frameworks (IADB, 2000; ADB, 2001), or are in process of doing so. It is beyond the scope of this paper to cover fully these developments, and what follows in this section simply focuses on the main opportunities, constraints, and options for external financing of social protection.

The limited impact of aid in securing growth and development has been acknowledged in the literature, and most recently in a World Bank study, *Assessing Aid* (World Bank, 1998). In the context of social protection aid, international donors show a strong bias for short-term, discrete, sectoral, and infrastructure programmes, instead of direct support for the development or strengthening of social protection programmes (See Figure 3 for an example). The latter would in most cases require inter-sectoral and integrated interventions sustained over time, and reliance to an important extent on cash transfers. There are many obstacles in the way of donors' financing of social protection.

Figure 3 Grenada: donor sectoral annual contribution to national development 2000–0



Source: data from European Community (2001)

Are different forms of aid support more or less appropriate for social protection? Different types of aid support include: structural adjustment finance, provided by the IMF and World Bank to support a programme of policy reforms; general budget support, provided through the government budget, either as general support or targeted on specific sectors; and programme or project aid, providing finance earmarked for expenditure in pursuit of specific programmes or projects managed either by government/government agencies, or donors. There are advantages and disadvantages with the different aid instruments, but in what follows budget support is given greater consideration, given DFID's reliance on this for of aid support.

The type of social protection intervention that the funding is meant to support makes a difference as well. This ranges from large-scale and long-term development of integrated social protection systems (for example, the introduction of a conditional targeted cash transfer programme for the rural vulnerable, as in Progresa), to self-standing medium-term sectoral programmes (for example, a municipal health insurance scheme), to one-off contributions to stabilisation funds. In what follows, we have in mind the first option.[14]

There are some general issues which will need to be considered before turning to the question. An important issue is the extent to which conditionality may be a useful tool for reinforcing policy reforms and aid effectiveness, in our case the development of social protection. There are some types of aid support aimed at strengthening social protection which can be buttressed by conditionality, and other types where conditionality is unlikely to be effective. Table 2 below summarises the main lessons form the literature. Another issue is whether aid support can be earmarked for specific social protection objectives.

Table 2 Types of aid support and social protection

Aid type	Social protection?	Conditionality?	Earmarking?
Structural adjustment	• Scope for supporting social protection is low • Social protection introduced in the midst of a crisis is unlikely to be effective • Polarisation is highest during a crisis and unlikely to result in a new social contract	• Targets macro-variables; • Policies which may be effective in dealing with crises may not be those that best protect the poor and vulnerable, and conditionality may involve a trade-off; • Need to ensure adjustment lending does not *increase* vulnerability (Box 3) • Macro and fiscal stabilisation rules may contribute to reduce vulnerability after the crisis	• Not appropriate
Budget support	• Requires a vulnerability assessment; • Effective only if aid is a significant share of budget and there is agreement on policy priorities between donors and government • Requires effective institutions for policy reform and coordination across ministries and provinces • Requires civil society monitoring and participation	• Appropriate to ensuring financing is additional to current government budgetary support • Appropriate to ensure coordinated policy priority • Appropriate to ensuring the right instruments are targeted on vulnerable groups But: • Difficulty in identifying indicators; indicators deteriorate over time • No clear link between public expenditure and outcomes • Use of MDGs? Competition with MDGs?	• Effective only if fungibility of government spending is limited • More effective in sectoral budget support, but at this level the boundaries with conditionality become blurred
Programme or project aid support	• Vulnerability Assessment a pre-requisite • More 'expensive' in terms of political support and cooperation with stakeholders • Scope for 'co-funding' with government and other donors • Requires investing in technical capacity first • Enables multi-country and regional scope • Can have large demonstration effects	• Appropriate to the use of the funds	• Appropriate and effective • Direct monitoring of disbursement and outcomes by donors

Sources: DFID (mimeo); Collier and Dollar (2002); Cordella and Dell'Ariccia (2003).

DFID has stated its intention to rely to a larger extent on budget support in the context of its poverty reduction objectives (DFID, 2004). This is based on wide-range dissatisfaction with the effectiveness of project aid. By comparison, the expectation is that budget support aid modality will provide a partnership-based, predictable, and transparent mechanism for establishing a more productive policy dialogue which supports institutional development, and especially government policy ownership and leadership, in the recipient countries. In the context of this paper, the issue is how best budget support can be used to strengthen social protection.

The effectiveness of budget support aid is dependent on the quality of the partnership between donors and the national government. This is of some importance given that budget support signals a move away from *ex ante* conditionality. In the same way that PRSPs can provide the basis for achieving a common understanding on poverty reduction goals, objectives, and targets, a vulnerability assessment is key to developing a commonality of purpose around social protection. Vulnerability assessments also enable a process of learning and understanding within government and civil society of the scope of social protection. Through these, vulnerability assessments enable domestic ownership on related policy.[15]

Strengthening institutional capacity through budget support suggests a number of advantages with this aid modality in the context of social protection. Social protection will be more effective if it integrates interventions across sectors (see Box 1 on Progresa), and coordinates the efforts of a range of providers within the public, voluntary, and private sectors. Budget support can more easily identify these linkages, and support them effectively, especially compared with project aid. Budget support is also, on paper, more flexible in responding to changes in the pattern and significance of risks. Disbursement is more flexible.

A move to budget support implies abandoning the conditionality paradigm but, as a recent report suggests, this does not rule out specific expectations on the part of donors regarding outcomes (OPM and ODI, 2002). This is inevitable, given the political exposure of donors. A vulnerability assessment will provide a basis for formulating these expectations, and will generate indicators and targets. These can be effective in the policy dialogue. An issue is that the scope of social protection might make it hard to identify appropriate indicators. Box 2 discusses this issue in the context of protection from macroeconomic shocks and cycles. Because social protection targets poverty today and tomorrow, identifying indicators of the probability of poverty and the exposure to future poverty might constitute a more difficult undertaking than identifying indicators of current poverty.

Box 2 Monitoring the social protection dimension of fiscal policy

Governments concerned with securing economic and social development should aim to protect the vulnerable from the impact of macroeconomic shocks and natural hazards. To achieve this, they must save in good times in order to be able to spend in bad times. Social spending on the vulnerable must be counter-cyclical. An effective development strategy requires that governments work to ensure that natural hazards or recessions do not derail the consumption and investment plans of households and communities.

What are the indicators to watch? The ratio of social spending to total government spending tells us something about whether governments are ‘pro-social’ or not. Governments that cut social spending during recessions are not ‘pro-social’, even if they raise this spending during recovery. Even if governments manage to protect social spending from cuts during bad times, they may not be ‘pro-social’. Macroeconomic crises increase unemployment and poverty. Unemployment cuts government revenue and therefore total spending, while rising poverty increases the numbers of potential beneficiaries. Even if social spending as a proportion of total government spending stays the same, lower total spending and an increased numbers of poor and unemployed people will result in lower social spending per head of the poor or vulnerable. The latter is the relevant indicator.

Sources: (Hicks and Woodon 2001; Braun and di Gresia 2003).

The move to budget support does not (i) apply to aid allocated to non-governmental organisations, and (i) rule out project aid altogether. An issue related to the monitoring and evaluation of budget support is the need for independent monitoring from research and policy institutions and from NGOs. It is important to keep this in mind in order to strengthen aid effectiveness. Project aid may be important to support the development of innovative projects

(OPM and ODI, 2002). It also relates to the point made here in the final section regarding the demonstration effect of successful social protection programmes such as Progresa.

Box 3 Ensuring aid does not worsen vulnerability: ADB Social Protection Conditionality on lending

ADB has recognised the social protection collateral issues in projects where social protection is not the main objective and has committed to:

1. Mitigating unintended adverse effects of loans on workers and vulnerable groups. Vulnerable groups that are adversely affected by ADB interventions should be adequately compensated and mitigation measures put in place to avoid creating further vulnerability.
2. Compliance with labour standards: (a) in the design and formulation of its loans, ADB will comply with the internationally recognised core labour standards; (b) ADB will take all necessary and appropriate steps to ensure that, for ADB-financed procurement of goods and services, contractors, sub-contractors and consultants will comply with a country's labour legislation as well as core labour standards; (c) as part of its regular loan reviews, ADB will monitor compliance with (a) and (b).

Source: ADB (2002).

The term structure of social protection is also an important issue. Social protection interventions are most effective in the medium and long term. A conditional targeted cash transfer programme, for example, will need at least one year for the collection of baseline data needed to optimise the design of the programmes, establish criteria for selection into the programme, and set up the administrative structure of support and monitoring. One, or possibly two, further years will be needed to implement the programme. Evaluation could be done in year three from the start of the programme (the evaluation of impacts on health status, nutrition, and educational attainment, for example, require that some time elapses from the start of the programme). It would be reasonable to estimate that such a programme would need five years or more to complete its first phase. Even if the programme is successful, it may well be necessary to continue it for a decade or more. This is in stark contrast to the kind of horizon favoured by donors, and the term structure of aid support (leaving infrastructure projects aside).

This is not just because of donors' time preference. To discontinue a social protection programme through lack of funding may increase the vulnerability of beneficiaries. The optimal length of time of a social protection programme may extend beyond the maximum period to which a donor may be willing to commit. For longer-term programmes, establishing partnerships with government and other donors will be important. Donors may be in a position to finance in full the start of a programme, but rely on the commitment of the government to (gradually?) take over the financing of the programme after it has been successfully established.[16]

At the other end of the range of options open to donors in terms of financing social protection are one-off contributions to commodity or fiscal stabilisation funds (see Box 4). Commodity stabilisation funds protect the government and producers from price and demand volatility. Commodity stabilisation funds can be established by single countries, or groups of countries. Fiscal stabilisation funds, on the other hand, mitigate the impact of natural disasters or macroeconomic shocks on government revenues. These can also protect and facilitate public sector reforms and structural adjustment. Donors have a range of funding options here, one of which is to make one-off single contributions to the fund.

Box 4 Stabilisation funds

Commodity Stabilisation Funds: STABEX is a mechanism introduced to compensate African, Caribbean, and Pacific countries' producers for shortfalls in export earnings, and through this to contribute to greater stability and predictability in the environment faced by governments and farmers. The countries in these regions are highly dependent on commodity exports and are as a result exposed to the persistent fluctuations of commodity prices. STABEX has an automatic disbursement facility, and acts as an insurance plan. In the past, there have been occasional delays in disbursement owing to the need to negotiate a Framework of Mutual Obligations. This, together with restrictions on the level and allocation of funds to recipients, has sometimes undermined the insurance cover provided.

Fiscal stabilisation plans: Countries in the Caribbean Region are highly vulnerable to macroeconomic shocks and natural hazards. Because they are small states and because these risks affect many of them at the same time (covariate risks), it makes sense to develop regional support mechanisms. At a 2002 Meeting of Heads of State of the Caribbean Community, it was agreed to establish a Caribbean Stabilisation Fund, drawing on country fiscal surpluses and international donors' contributions. The Fund will assist Caribbean countries with support for counter-cyclical fiscal policy and the process of economic and public sector reform.

5 Key issues and conclusion

5.1 The cost of raising revenue for social protection

Cost of social funds versus 'double dividends'. The public finance literature suggests there are costs to a market economy of raising revenue through taxation. Payroll taxes may reduce the incentives for work for marginal workers, and taxes on non-labour income may reduce the incentives to save. There are, therefore, welfare costs to raising taxes.[17] This implies that in order to finance £1 for public expenditure, it may be necessary to raise £1.25, say, in revenue. The marginal cost of social funds may be greater than the amount needed for expenditure.[18] At the same time, taxation may bring additional benefits to the economy, a social dividend, if for example carbon taxes reduce environmental damage in addition to raising revenue for public expenditure. There is a clear case for the presence of a social dividend where taxes correct market imperfections. In this situation, the marginal cost of raising social funds may be less than the revenue collected. To the extent that social protection corrects market failures, in insurance, skills, and time preferences,[19] it can be argued that the marginal cost of raising funds for social protection may be less than the actual spending.

5.2 Social protection's impact on growth and development: quantifying the gains

The argument in the previous point underlines how important it is to quantify the gains from social protection in order to make the case that social protection creates 'social dividends'. Table 3 below provides some rough estimates of the cost of uninsured risk and therefore the gains from social protection. This is important in persuading developing country governments and society to support social protection, but also voters in developed countries on the benefits of aid assistance targeted at social protection.

Table 3 The cost of not having social protection: some rough estimates of the effects of uninsured risk

Exposure to uninsured risk	Rough estimates of impact
1. Exposure to natural, economic, political (conflict) shocks reduces growth and development	• A study of the impact of the 1991–92 drought on six African countries showed real income contracted by 2% in South Africa to 8% in Malawi • Five case studies collected for an IMF report identified the impact on shocks on GDP growth as follows: Cambodia (drought/flood 1994) less than 1%; Zimbabwe (drought, 1992) 8.5%; Mali (export price shock, 1992–93) 1.8 % per year; Uganda (export price shock, 1987–92) 3.5 % per year for six years; Honduras (hurricane, 1987–92) 13,700 people dead or missing and direct damages 47% of 1997 GDP (IMF, 2003)
2. Exposure to risk causes transient poverty If optimal social protection is capable of stabilising income, then transient poverty is an upper bound measure of the impact of social protection	• In China, it was estimated that transient poverty accounts for one half of the squared poverty gap (Jalan and Ravallion) • In rural Ethiopia, transient poverty accounts for 45% of the squared poverty gap (Dercon and Krishnan)
3. Exposure to risk also causes chronic poverty	
a. through lower farm productivity from choosing low return low risk crops compared to better insured farmers	• In India, ensuring the poorest quartile enjoy the same protection against rainfall time variation as the top quartile, would improve farm profits by 35% (Biswanger and Rosenzweig). • In rural Tanzania, the cost to the poorest quintile arising from growing low-return/low-risk crops is lower returns by 20% compared with the wealthiest group
b. through impact of shocks on the asset base of the poor	• In Ethiopia's famine years 1984–85, 60% of households reported having had to sell livestock, and herds declined by 40%; 90% of households reported having cut back on food consumption (Dercon). By 1994 herds were still only 87% of pre-famine size
b. through the impact of shocks on human capital	• The impact of crises on schooling has been observed in a wide range of developing countries, and especially among larger countries such as Brazil, India, and Indonesia • The impact on nutrition has also been observed for many countries, in Zimbabwe, a severe drought resulted in poor nutrition and stunting, with permanent loss of 1–2 centimetres on average (Hoddinott and Kinsey) • In Mexico there is evidence that crises result in cuts in spending on healthcare and nutrition for the young and old, leading to higher mortality rates for these groups (Cutler *et al.*)

5.3 Ensuring additionality in the financing of social protection

From the perspective of donors and civil society, one issue with aid conditional on improving the social protection efforts of government is whether this will in practice involve extra resources or simply a switch in resources. Some switch in expenditure from less effective poorly targeted programmes is welcomed. But to the extent that social protection addresses vulnerability instead of poverty, and given that non-poor vulnerable groups may be large in developing countries, social protection might lead to a switch of spending away from current poverty reduction. This is also for political economy reasons, as the non-poor vulnerable may have greater influence on policy.[20] This is the kind of trade-off that could be avoided by ensuring social protection financing is additional and focuses on the more vulnerable groups.

5.4 The protection mix: investment versus consumption

What is to be protected? Different social protection programmes have a different mix in terms of support for current consumption or investment. The case for social protection as a springboard rather than a safety net rests on the emphasis on investment as the priority. The political economy dimension on this is that in general, voters are more comfortable with supporting investment rather than consumption (see Graham, 2002). This is also the case with donors, who are more comfortable with infrastructure and other investment projects, and reluctant to finance cash transfers, for example.

One of the reasons behind this is to do with the fungibility of household income. Studies for developing countries suggest that this fungibility works in very positive ways. Cash transfers to support old people are in fact used to support the household as a whole, and with a mix of consumption and investment (Delgado and Cardoso, 2000; Barrientos and DeJong, 2004). In South Africa, for example, pensioners commonly use their income to pay for the school fees of their grandchildren. Other cash transfers are also used for investment purposes (Devereux, 2001).

Conditional targeted cash transfer programmes use conditionality to ensure a minimum investment is made by beneficiary households, by making cash transfers conditional on school attendance and visits to health clinics (Barrientos and DeJong, 2004). At the very least, this suggests that it is possible to seek to influence the mix of consumption and investment within social protection programmes, and that it is feasible to meet the concerns of voters and donors as regards investment. Table 4 provides a short description of conditional human development programmes, their key characteristics and funding. As can be seen from the table, financial and technical support from multilateral organisations has been an important factor in the establishment of these programmes. In most cases, the funding committed by the multilateral organisations is limited to the costs of baseline studies and the initial costs of establishing the programme.

5.5 Partnerships, politics, and the term structure of social protection

It was remarked above that the term structure of aid might be too short for the time framework involved in social protection programmes. It was also noted that external financing may provide the start-up funds needed, which are substantial. This has been a feature of the programmes reviewed in Table 4. Persuading governments to commit to absorbing gradually a social protection programme can be facilitated if it can be shown that the programme is effective, and political support for it is forthcoming. This involves, necessarily, a partnership with governments and a dialogue with civil society to engender the basis for a new social contract.[21]

Table 4 Targeted conditional human development programmes

Country and title	Type	Coverage	Conditionality	Finance	Budget
Bangladesh Food for Education	initially targeted in kind transfer conditional on schooling, later cash transfer – demand subsidy	2.4m children (2000)	minimum school attendance (85%)	Government of Bangladesh	US$77m in 2000
Honduras *Programa de Asignación Familiar* PRAF	targeted conditional cash transfer – demand subsidy and supply side support	4.7% of population. Poor households with children aged 0–3 and 6–12 who have not completed 4th grade	school enrolment and absences less than seven days in one term and not to repeat grade more than once; plus regular visits to healthcare providers	IADB (US$45.2m), Honduras Government (US$5.1m)	0.019% of GDP
Mexico *Progresa (Programa de Educación, Salud y Alimentación)*, then in March 2002 changed to Oportunidades; extended to urban areas in 2003	targeted conditional cash transfer – demand subsidy and supply side support	initially rural households with children 7–14 in school, 3.2 m. households (2001); 40% of rural households, 3.38% of population	enrolment of 6–17 year olds in grades 3–9 and 85% school attendance; attendance to health providers and information sessions	Mexican Government	US$1.8b or 0.32% of GDP in 2000
Nicaragua *Red de Protección Social*	targeted conditional cash transfer – demand subsidy and supply side support	poor households and poor households with children 7–13 who have not completed 4th grade; 10,000 households 60,000 individuals; 1.21% of population	school enrolment; no more than six days absent in two months; school grade promotion; monthly or bimonthly visits to health centre for children 0–5; up-to-date vaccination programmes; mothers' attendance to seminars on nutrition and hygiene	IADB and FISE Fondo de Inversion Social de Emergencia	US$5m (2002) or 0.021% of GDP
Brazil PETI Child Labour Eradication Programme	targeted schooling subsidy and supply side provision of extended school day	poor households with children aged 7–14 working in hazardous or degrading conditions, 866,000 beneficiary children in 2002	school attendance (80%) in a three-month period; participation in after school sessions; participation by parents in educational and income generating sessions	ILO, World Bank, USAID, UNICEF	472.4m reais in 2002 or 0.04% of GDP
Brazil *Bolsa Escola*	targeted conditional schooling demand subsidy – conditional cash transfer	poor households with children aged 6–15; 5m households and 8.2m children; 4.7% of population	school enrolment and 85% school attendance	Brazilian Government	US$800m or 0.13% of GDP
Colombia *Familias en Acción*	targeted conditional cash transfer – schooling and health demand subsidy	poor households with children 0–17; 362,403 households (2002)	80% school attendance in a two months cycle; regular visits to health providers for monitoring of children's growth and development		US$100m (2004) or 0.12% of GDP

Jamaica Programme of Advancement through Health and Education PATH	targeted conditional cash transfer	poor households; 236,000 individuals are the target beneficiary population	visits to health centres; school enrolment of children aged 6–7, minimum attendance 85% of term	World Bank and Government of Jamaica	US$22m (2003) or 0.29% GDP
Turkey Social Fund	targeted conditional cash transfer – schooling demand and health subsidy	poor households with children below seven years of age, or attending school; 22,000 beneficiaries in pilot programme (April 2003)	school attendance for children of school age and health care visits for children below school age	Government of Turkey and World Bank	US$120m (2004) or 0.06% GDP
Chile *Chile Solidario*	targeted integrated support gateway with cash transfers	households in extreme poverty 113,116 (target 2003) eventually covering 209,398 households in 2005	gateway participation is conditional on a household contract	World Bank and Government of Chile	

Sources: see Barrientos and DeJong (2004).

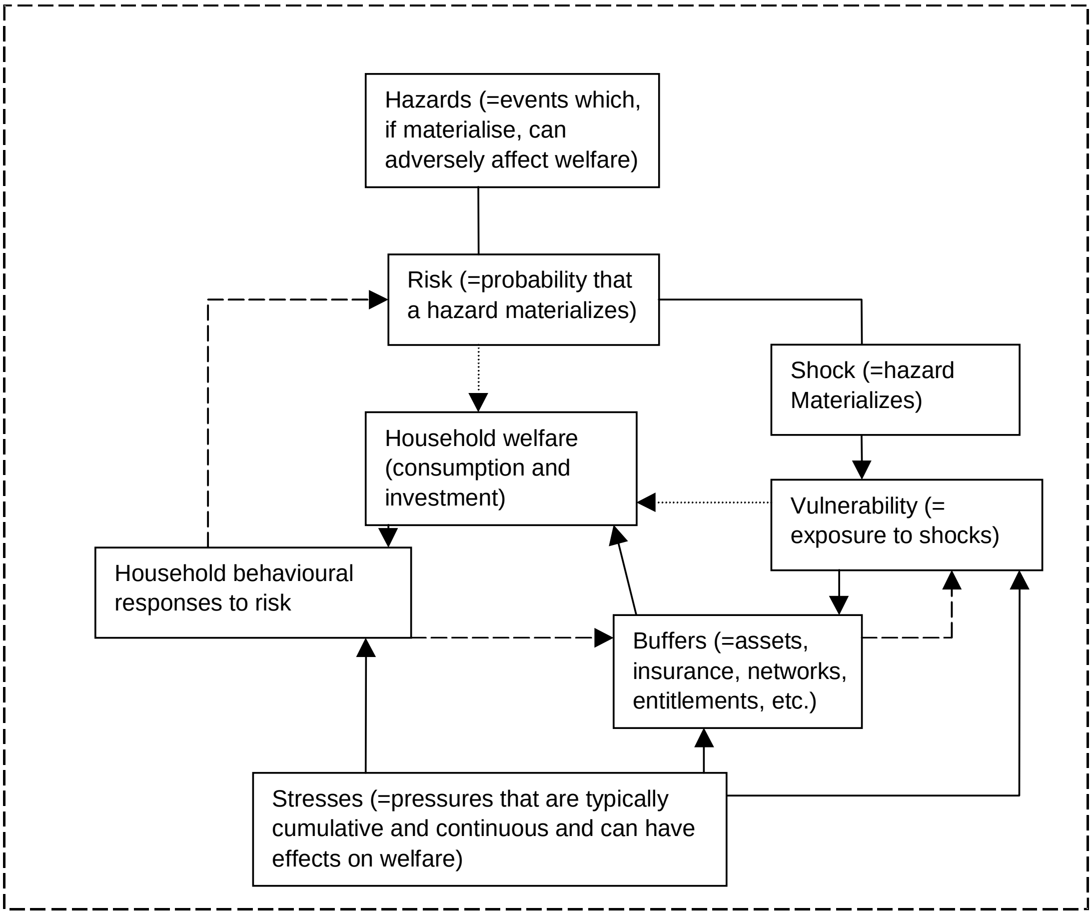
Where is DFID's comparative advantage in the financing of social protection? As indicated above, the ILO and WB have developed a substantial lead on social protection. The ADB, IADB, and CDB have established, or are in the process of establishing, social protection policy frameworks. The ADB is well advanced in terms of lending and technical support. DFID's livelihoods approach to development and its regional focus suggest that partnerships with donors working on social protection might be a good way of leveraging resources. There are functional and regional areas of expertise within DFID which could be useful here. DFID's work on education, health and HIV/AIDS could be used to leverage social protection. DFID's work with civil society and NGOs provides an opportunity to focus on strengthening community monitoring of social protection priorities. Stabilisation funds and protection against natural hazards provide opportunities for discrete, short-term contributions. At a broad level, ensuring that social protection remains focused on the poorest and most vulnerable would constitute a high-return contribution to global social protection policy from DFID.

5.6 Crucial experiments?

How to enhance support for social protection? There are different channels through which a stronger focus on social protection can be achieved. For example: exhortation of national governments and international organisations backed by aid support; the development of a social protection policy framework which would provide a distinctive position for DFID; and budget support with effective conditionality. The disadvantages of budget support are well known. To be effective, budget support requires effective systems of budgetary planning, control and management, and a commonality of purpose existing between donors and national governments. In the area of social protection, aid support for a specific programme instrument, one which is capable of showing that social protection can be effective and can make a contribution to improving wellbeing as well as growth and development, has been a way of shifting the international and national development policy debate.

In sum, there are significant opportunities for donors to contribute to strengthening social protection in developing countries. There is an emerging consensus that social protection provides a framework for development policy capable of addressing rising poverty and vulnerability. There are important constraints to the capacity of national governments to extend social protection; switching expenditure is a protracted process, and the constraints on revenue-raising are strong. International organisations have an important role to play in financing social protection, but there are many difficulties in the way. Their preference for short-term, sectoral, and infrastructure project lending, and the ineffectiveness of conditionality in structural adjustment and budget support, restrict the options for supporting social protection. Strengthening social protection in developing countries may require sustained financial support and engagement with civil society, around integrated policy interventions. Nevertheless, a range of options exists. In the context of human development programmes, provision of start-up funds and know-how has led to the establishment of ambitious social protection programmes. At the other end of the range, one-off contributions to fiscal stabilisation plans can provide room for strengthening counter-cyclical fiscal policy. The same applies to natural disaster and emergency funds.

6 Annex: Linkages from vulnerability to welfare



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8 Endnotes

[1] International organisations have developed their own definitions of social protection emphasising their main concerns and approaches (Barrientos, 2004).
[2] See Annex for a description of the linkages from vulnerability to welfare.
[3] The distributional impact of macroeconomic crises is an important issue here. Reviewing the experience of Latin American and Caribbean countries, Lustig finds that 'for every percentage point decline in growth, poverty rises by 2 percent' (Lustig, 2000).
[4] For small countries, regional or international stabilisation funds, such as the one proposed for the Caribbean, may constitute an appropriate response (CARICOM Secretariat, 2002).
[5] See (Braun and di Gresia, 2003) for a more detailed discussion.
[6] We would include here expenditure on early childhood interventions, primary education, primary healthcare and public health, nutrition programmes, social services and social assistance. Public expenditure on disaster preparedness and emergencies may be important in some countries.
[7] This would involve finding the level of public expenditure on social protection at which the marginal benefits equal the marginal cost of social funds.
[8] The categories of expenditure used in the figure are those used in IMF Government Finance Statistics Yearbook. Social security and welfare expenditure covers transfers payments (including in kind) to compensate for reduction or loss of income or inadequate earning capacity; sickness, maternity, and temporary disablement benefits; government employee pension schemes; old age, disability or survivor benefits; unemployment compensation benefits; family and child allowances; other social assistance to persons and to residential institutions for children or the elderly. Transfers to organisations and households cover current transfer payments to private social institutions, such as hospitals or schools, learned societies, associations, and sports clubs that are not operated as enterprises; current payments in cash (not in kind) to households, adding to their disposable income without any simultaneous, equivalent counterpart provided in exchange by the beneficiary, and neither generating nor extinguishing a financial claim; usually intended to cover charges incurred by households because of the appearance, or existence, of certain risks and needs.
[9] A shift of this nature could be facilitated by conditionality. The ILO has championed social budgeting as a tool for identifying potential gains from switching public expenditure, and to facilitate their implementation. An experienced ILO official suggested to me that it takes 10 years to shift 1% of GDP.
[10] Auriol and Warlters argue that the excess burden of taxation (the amount of income that is lost in excess of what the government collects) should be similar across developed and developing countries in the context of indirect taxation, but significantly lower in developing countries in the context of direct taxation (Auriol and Warlters, 2002).
[11] In developed countries, concerns over the employment effects of higher payroll taxes have been researched extensively. In developing countries this is not the case. Gruber examines a 'natural experiment' in which payroll taxes experienced a large one-off change without a significant impact on employment (Gruber, 1997)
[12] To the extent that increased taxation provides a corrective instrument for market imperfections that cause inefficiencies, the tax 'burden' could become a 'benefit', for example as a result of introducing a carbon tax (Atkinson, 2003). The burning of hydrocarbon fuels is an important factor in global warming, and because the fuels contribute in proportion to their carbon content, a tax on their use in proportion to the amount of carbon burned would generate significant revenues, and a reduction in the use of environmentally harmful fuels (Clunie-Ross, 1999).
[13] Indonesia provides a good example. In 2002, the poverty headcount was 13.1%, using the USUS$1 a day poverty line, but a vulnerability headcount of 53.4% results from applying a USUS$2 a day vulnerability line. More sophisticated measures of vulnerability arrive at roughly the same figure (Suryahadi and Sumarto, 2001).
[14] There is a further option: cross-country or regional, or even global, social protection interventions. This is not discussed in any detail in the paper, given the scope of DFID's aid effort. They are becoming quite prominent in the social protection agenda, for example the Global Fund to fights AIDS, Tuberculosis and Malaria; the Vaccine FUND associated with the Global Alliance for Vaccination and Immunity; the ILO's eradication of child labour programme, the ILO's Global Social Trust, Peter Townsend's proposal for a universal child benefit. Social protection covering global issues, such as HIV/AIDS and migration, is necessarily global.
[15] It will be hard to develop such partnerships without a vulnerability assessment, mapping the key risks faced by the population in the country, the social protection instruments available, and identifying gaps and overlaps. Achieving an understanding of social protection for effective policy involves clarifying the linkages and differences existing among social protection, poverty reduction, and development strategies. The difficulties in successfully achieving such understanding should not be underestimated. There is a risk that vulnerability

assessments are perceived as just another poverty assessment, and that governments may simply repackage their development objectives as social protection interventions.

[16] The term structure for this contract may be an issue. The Global Social Trust programme, for example, envisages the provision of start-up capital and know-how for open-ended projects, with a gradual withdrawal of the trust after 10 years. There is also a political economy dimension to this. Once a programme becomes established, and evaluations show effectiveness and impacts, it becomes easier to ensure its political sustainability.

[17] In addition, there are costs associated with administration and enforcement of tax rules.

[18] The marginal cost of public funds is 'the multiplier to be applied to the direct resource cost in order to arrive at the socially relevant shadow price of resources to be used in the public sector' (Sadmo, 1998: 366).

[19] One explanation for persistent poverty and vulnerability is that short time preferences among the poor, owing to education and information deficits for example, preclude investment in their human capital.

[20] A good example is provided by the WB focus on pension reform after its 1994 'Averting the old age crisis' report. The Bank initially focused on reforming public and occupational pension plans for formal workers, before focusing its attention on non-contributory pensions which focus on the poor.

[21] This is in line with the findings of *Assessing Aid* on what makes aid successful (World Bank 1998).