Briefing Paper February 2009

Strengthening Social Protection for Children

reduction of poverty social exclusion strategy security social protection inequality

Social Policies

policies Children's Rights

social protection reaching the MDGs

Fiscal space for strengthened social protection in West and Central Africa

Introduction

Social protection has received increasing attention in recent years as a powerful mechanism to reduce vulnerability and poverty, in particular among children. There is a growing body of evidence regarding the benefits of cash transfers in particular. In addition to helping the poor to purchase productive inputs and assets, and so raise their productivity, cash transfers make it possible for them to improve nutrition, access education and health care and avoid harmful coping strategies such as child labour. These improvements in child well-being and child development contribute, along with increased household productivity, to long-term poverty reduction.

However, while rigorous analysis of the impact of social protection is clearly important, understanding the fiscal and political feasibility of such schemes is equally important if they are to be adopted and successfully implemented by developing country governments.

One potential angle for approaching these issues is to consider fiscal space. This briefing paper presents the results of a recent overview of fiscal space for social protection in five countries in West and Central Africa: the Republic of Congo, Equatorial Guinea, Ghana, Mali and Senegal[1].

Key points

1. The low-population, oil-rich countries of the Gulf of Guinea have adequate fiscal space for much larger resource commitments to social protection. Both universal child benefits and social pensions would be affordable.
2. In poorer countries, only more modest social protection programmes would be fiscally viable. For example, in Ghana, the LEAP cash transfer programme could be scaled up to reach all extreme poor households for less than 1% of GDP.
3. The main challenge is to develop the necessary political commitment, governance conditions and administrative capacity.

[1] The study was part of a broader research programme on social protection and children in West and Central Africa, sponsored by the West and Central Africa Regional Office of UNICEF, and carried out by the Overseas Development Institute (ODI) in London, with the participation of researchers from the region. The report on fiscal space for social protection was written by Geoff Handley and has been published jointly by UNICEF and ODI.

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What is fiscal space?

Fiscal space can be defined as the *'room in a government's budget that allows it to provide resources for a desired purpose without jeopardising the sustainability of its financial position or the stability of the economy'*[2]. The basic rationale is that such space needs to exist or be created in order for governments to increase spending on national priority areas, which may include social protection, in a sustainable manner. Fiscal space is likely to be particularly difficult to create, or preserve, in many developing countries as a result of the current global financial crisis. However, the need to protect the poorest and most vulnerable from the livelihood shocks resulting from the crisis underlines the importance of social protection expenditure, as well as the case for the strengthening of social protection programmes (where fiscally and politically feasible) in countries where these are weak, as in most of Africa.

Different types of expenditures will have different impacts on the available fiscal space in the medium to long term through their impact on fiscal sustainability. Social protection payments may contribute to economic growth by enabling the poor to invest in productive assets and human capital (through investments in their children). However, they may also create costly entitlements that represent a significant contingent liability for the state, particularly if poorly administered so as to undermine their growth impact.

Fiscal space and the politics of the budget

Fiscal space is converted into specific expenditures through the national budget process. Most budgeting is inherently incremental and only a very small percentage of the budget is reallocated to new policy initiatives (such as a new social protection scheme) from year to year: the government's annual 'margin of manoeuvre' for new programmes is typically no more than 5% of total budgeted expenditure[3]. The central question for most countries in West and Central Africa, except for a few oil-rich countries in the Gulf of Guinea, is not whether they have surplus funds available today, but whether they have the capacity to build that space gradually, perhaps finding around 1-2% of GDP over the next 5-10 years.

It is important to note the importance of politics in the allocation of fiscal space. Good practice rightly emphasises the central role of domestic political processes in deciding where public funds are spent – and ideally these trade-offs should be formalised within a policy-based budget process. This is one of the hallmarks of genuine government 'ownership' of public policy. New social protection programmes therefore require political support as well as fiscal space.

Moreover, in many developing countries, the formal budget process often conceals a more important informal process for budgetary decision making. These political considerations mean that, even where prospective fiscal space is identified, there may not be corresponding political commitment within the executive to pursue reallocation, or that available funds may be used for political or clientelist purposes rather than for developmental ends.

This also raises the question of what should be done in countries without sufficient fiscal space and domestic political support? One common strategy is to introduce social protection schemes as aid-financed projects. This circumvents both the need to find fiscal space in the recurrent budget

[2] P.S. Heller (2005), Understanding Fiscal Space. Policy Discussion Paper PDP/05/4. Washington, DC: International Monetary Fund.

[3] S. Schiavo-Campo and D. Tommasi (1999), Managing Government Expenditure. Manila: Asian Development Bank.

and the politics of the domestic resource allocation process. However, while such an approach may provide much needed help to the poor and vulnerable, it risks creating unsustainable schemes that lack domestic political support or sustainable financing, limiting the prospects for sustainable 'scaling-up'. It is also important to understand how such programmes relate to existing patronage structures if funds are to reach their intended beneficiaries.

Measuring fiscal space: an indicative framework

There are six principal mechanisms for the creation of fiscal space: i) increasing revenue through either increased economic activity or increases in the average tax yield as a proportion of GDP; ii) reallocating spending from lesser to higher priorities and from lesser to more effective and productive programmes; iii) reducing debt by writing off all or part of a country's debt stock with a view to freeing up resources that would otherwise be spent on meeting debt service obligations; iv) increasing borrowing from either external or domestic sources; v) increasing aid in the form of grants and concessional loans; and vi) seignorage, or generating revenue by money creation.

However, although fiscal space can be created relatively easily over the short term, the real challenge lies in sustaining it – i.e. creating fiscal space that lasts. This is particularly important in the context of social protection, which requires governments to enter into long-term recurrent (i.e. operational) expenditure commitments. The nature of these commitments demands prudent choices in terms of generating fiscal space. Of the six mechanisms highlighted above, increasing revenue and reallocating spending offer the best options for national government policymakers seeking to build lasting fiscal space for social protection.

It is also important to examine the prospects that additional spending can be properly managed and that the macroeconomic framework can withstand the increases in demand pressures that increased public spending is likely to stimulate.

The cost and affordability of cash transfer programmes

Simulations were run to estimate the costs of different types of cash transfer programmes in the five countries covered by the study. To facilitate the assessment of affordability, costs are expressed in relation to GDP and recurrent government expenditure.

Three options were examined: a universal child benefit, a targeted child benefit (for children in households under the poverty line) and a universal social pension. Child benefits were for children aged 0-14 and were set at 30% of the extreme (food) poverty line. Social pensions for the elderly were set at 70% of the extreme poverty line. Universal schemes were assumed to have administrative costs equivalent to 10% of the value of transfers, while administration of the targeted scheme was assumed to cost 15% of the value of transfers.

The results of the cost simulations are presented in Table 1 and discussed in Box 1.

By expressing the simulated costs as a proportion of recurrent expenditure, Table 1 gives an indication of how feasible it is to create the room in the government budget required to finance social protection programmes.

Table 1. **Simulation results: cash transfer costs as % of GDP and recurrent expenditure**

		Universal child benefit	Targeted child benefit	Social Pension
Congo	% GDP	2.0	1.2	1.0
	% recurrent expenditure	16.7	9.9	8.3
Equatorial Guinea	% GDP	0.9	n/a	0.2
	% recurrent expenditure	20.8	n/a	5.0
Ghana	% GDP	8.7	n/a	2.6
	% recurrent expenditure	46.3	n/a	13.9
Mali	% GDP	5.9	3.2	n/a
	% recurrent expenditure	42.8	23.5	n/a
Senegal	% GDP	6.4	3.7	n/a
	% recurrent expenditure	30.0	17.6	n/a

Sources: G. Notten, B. Buligescu and A. Mpoue (2008), Policy Options to Reduce Child Poverty and Improve Access to Education and Health Care in the Republic of Congo. Brazzaville: UNICEF; A. Barrientos (2008), 'Cost Simulations of Child Transfer and Social Pension Schemes in Equatorial Guinea and Ghana', paper for ODI, London, and UNICEF WCARO; A. Barrientos and L. Bossavie (2008), 'The Poverty Reduction Effectiveness of Child-Focused Social Transfers in Mali and Senegal: Ex-ante Simulations', paper for ODI, London, and UNICEF WCARO.

Box 1. **Fiscal space opportunities and constraints in the five case study countries**

Congo shows significant potential fiscal space. The key macroeconomic and fiscal aggregates suggest that a universal child benefit would be affordable, costing 2.0% of GDP compared with an overall fiscal surplus of 11.1% of GDP in 2007. However, the very low levels of health and education spending (2.2% and 1.2% of GDP, respectively) suggest weak government commitment to converting oil wealth into fiscal space for improved social service provision, and poor performance on measures of institutional quality imply that managing social protection expenditures and programme delivery may prove challenging.

Equatorial Guinea is by far the strongest candidate country for the affordability of social protection provision, as an oil-rich country with a very small population. The estimated costs of social protection are relatively low for Equatorial Guinea when expressed as a proportion of GDP – both a universal child benefit and universal social pension could be provided for a combined cost of around 1% of GDP, while the overall fiscal surplus in 2007 exceeded 22% of GDP. However, although social protection is clearly affordable in simple aggregate terms, it is not immediately clear whether sufficient organisational capacity exists to develop and administer social protection programmes.

Ghana, in the short term, is probably the least able to afford a large increase in spending on social protection among the case study countries, notwithstanding possible future revenues from recently discovered oil reserves. A child benefit, even if targeted to children in households below the poverty line, would be difficult to afford, as would a social pension. An alternative option might be to consider an expansion of the recently launched Livelihood Empowerment Against Poverty (LEAP) cash transfer programme to cover all extreme poor households – at present it is planned to spend only 0.1% of GDP to reach one-sixth of extreme poor households within five years. Coverage of all households below the extreme poverty line would be affordable, costing less than 1% of GDP.

In **Mali**, cost estimates suggest that a targeted child benefit using a proxy means test could be provided at a cost of around 3.2% of GDP, which is unlikely to be affordable, given that this would be equivalent to Mali's entire public health expenditure (3.2% in 2004), while the overall fiscal deficit (including grants) was 3.8% of GDP in 2007. Only a more modest scheme (perhaps targeting the extreme poor with a lower benefit level) would be feasible in the short to medium term.

In **Senegal** there is limited scope for creation of fiscal space through revenue generation. Reallocation – rather than increases in total spending – may be an area where fiscal space could be created, as discretionary spending stood at 17.8% of GDP in 2007. Still, estimates suggest that social protection would be relatively expensive for Senegal. A targeted child benefit, using a proxy means test, would cost around 3.7% of GDP, which would be much higher than total public health spending (2.4% of GDP in 2004). As with Mali, more modest schemes may need to be investigated.

Conclusions

The overall picture is one of two broad country groups. First, the oil-rich countries of the Gulf of Guinea (including Congo and Equatorial Guinea) present a special case. As a result of soaring global oil prices and in some cases increases in the volume of oil production, these countries already have substantial available resources, with large overall fiscal surpluses (almost 10% of GDP in the case of Congo and Gabon and over 20% in the case of Equatorial Guinea in 2007). They also have low non-oil tax yields, which might be increased in the future. They thus have ample resources to finance additional expenditures on social protection, including a universal child benefit.

At the same time, these countries have the lowest proportions of public spending on the social sectors and the lowest measures of institutional quality, suggesting that simple affordability is not the key barrier to the expansion of social protection. Rather, the main barriers are political and institutional in these countries, as evidenced by their very low scores on measures of institutional quality. A further key consideration for these countries is the sustainability of increased levels of expenditure on new or expanded social protection programmes, given the volatility of the oil market and oil's nature as a finite resource. The fiscal sustainability of increased expenditures therefore relies upon both the diversification of these countries' narrow oil-based economies and the building up of reserves to smooth revenues and finance future commitments.

The three aid-dependent economies (Ghana, Mali and Senegal) form a second group, for which affordability is more of a problem. These countries spend a larger share of public resources on the social sectors, but tax yields and public spending are close to the limits of 'recommended' thresholds for fiscal and macroeconomic sustainability. All three had fiscal deficits including grants of 3.8% of GDP or more in 2007, and Ghana's deficit rose to 13.5% in 2008, the second highest in the region after Guinea-Bissau.

In these countries, measures of institutional quality are higher than in the oil-dependent countries, although still low by international standards. It may therefore prove possible to generate sustainable fiscal space for more modest social protection programmes over a 5-10 year period, generated through increased revenues and some reallocation of expenditures, coupled with a strengthened medium-term perspective and policy focus in the budget process.

Whether this fiscal space is allocated to finance social protection and whether such funds are used for their intended purpose will in turn depend on domestic political and institutional dynamics. In general, budgetary and political factors need to be much better understood if fiscally sustainable social protection programmes, paid for from recurrent budgets, are to be adopted, implemented and scaled up by governments in the region.

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