DFID Department for International Development

A DFID practice paper

Briefing

MARCH 06

SOCIAL PROTECTION BRIEFING NOTE SERIES NUMBER 4

# Social protection and economic growth in poor countries

## Summary

Social protection can have a positive impact on growth in developing countries in a number of ways. It can finance investment in health and education, protect assets that help people earn an income, encourage risk taking, promote participation in the labour market, and ease the pain of economic transition. There are inevitably trade-offs. For example, if taxes are raised to pay for spending on social protection, tax payers may have less incentive to work and save. However, social protection, in reducing poverty and inequality, can also lead to greater social unity and a more stable environment for individuals to work, save and invest. Governments must be careful to strike an appropriate balance between economic incentives and greater provision of social protection. Nevertheless, social protection is a potentially important part of a strategy to increase sustainable, poverty-reducing growth.

## Introduction

DFID's framework for pro-poor growth sets out four broad conditions that can help to accelerate pro-poor growth: (a) creating strong incentives for investment; (b) creating international economic links; (c) providing broad access to assets and markets; and (d) reducing risk and vulnerability.[1] Well-designed social protection programmes[2] can contribute to all four conditions, but are particularly effective in reducing risk and vulnerability and increasing access to assets and markets.

In OECD countries, economic success has gone hand-in-hand with investment in social protection – often more than 10 per cent of GDP (and over 30 per cent if access to health and education are included). This note explains how social protection can play an important role in delivering pro-poor growth in developing countries.

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[1] *How to accelerate pro-poor growth: a basic framework for policy analysis* (DFID Pro-Poor Growth briefing note, September 2004). The 2005 Operationalising Pro-Poor Growth study by DFID and international partners also identified a number of priorities to increase pro-poor growth, including improving education outcomes for girls, reducing risk, and increasing access to assets (*Pro-Poor Growth in the 1990s: Lessons and Insights from 14 Countries* (DFID, 2005)). Social protection can play a role in achieving all these priorities.

[2] Social protection comprises social insurance, for example contributory benefits and health insurance, and social assistance, such as non-contributory cash transfers and fee waivers. See *Social protection in poor countries* (DFID briefing note, January 2006) for a complete definition.

## Social protection can be an investment in the workforce …

Many potentially productive people in developing countries cannot participate effectively in the labour market or as entrepreneurs due to ill health and a lack of education. For instance, many millions live with and die from preventable diseases each year, and more than 100 million children are unable to attend primary school. As a result, the poor use assets less efficiently, productivity grows more slowly, and economies are less competitive than they would have been otherwise. Social protection can play a key role in improving health and education outcomes and providing a workforce that is better able to compete in the global economy.[3]

**Social assistance programmes, such as regular and predictable cash transfers, help the poor maintain a basic level of nutrition.** This helps improve the health of family members so that children can perform better at school, while adults can be more productive. For example, in the Oportunidades programme in Mexico, which gives cash transfers conditional on school and health clinic attendance, the number of work days lost to illness among adults has fallen by almost a fifth. Also, the growth of children between the ages of one and three years has increased by one centimetre per child per year in recipient families. Improved nutrition and reduced stunting among very young children are particularly important for their future participation in the economy as they cannot recover from early set backs in their physical and cognitive development.

**Social assistance programmes can also help with the costs of using services.** Fee waivers can significantly increase access to health and education services. But, even where there are no fees, the poorest families are excluded by the cost of travelling to clinics and to schools, of buying books and uniforms, and of lost income from child labour. Cash transfers can help. For example, in South Africa and Brazil, the receipt of old-age pensions is associated with increased school attendance, especially among girls aged 12 to 14 (educating girls is especially important in that it both improves their productivity and reduces fertility rates, which allows greater economic participation). And making transfers conditional on attendance at school and health clinics can achieve impressive results – in Bangladesh, the Cash for Education programmes has resulted in a 20-30 per cent increase in school enrolment among beneficiaries.

## … and can help the poor to cope with risk …

In developing countries, shocks such as a drought, death in the family, or reduction in commodity prices, are a part of every day life. For example, in rural Ethiopia, between 1999 and 2004, 95 per cent of the population suffered a serious shock.[4] Poor people are rarely protected or insured against these events. **As a result of their exposure to shocks, the poor and vulnerable can be forced into behaviour that can reduce productivity**. They are likely to mitigate risks by, for example, choosing more drought-resistant but less profitable crops. And, after shocks, they may sell productive assets such as farm animals, take children out of school, and

[3] See *Using social transfers to improve human development* (DFID Briefing Note, February 2006).
[4] http://www.economics.ox.ac.uk/members/stefan.dercon/research.HTM.

reduce their household's nutritional intake, which has a persistent impact on earnings.

**The cost of these coping strategies can be significant**. The WHO estimates that each year 100 million people are driven into poverty as a result of the cost of health shocks alone. In India and Tanzania, risk avoidance has resulted in the poor getting returns on their investments that are 25 per cent lower than the better-off.[5] In terms of the impact on the economy as a whole, the IMF has estimated that shocks reduced GDP by 3.5 per cent a year in Uganda between 1987 and 1992, when the prices of exports dropped sharply, and by 8.5 per cent in Zimbabwe following the 1992 drought.

**As a result of these costs**, **social protection programmes that protect poor and vulnerable households against shocks can generate high returns.** The provision of social protection means the poor and vulnerable are less exposed to destitution when their investments fail, which can make them more likely to take risks and invest in more profitable activities (poor people are not unusually risk averse, as is often assumed). For instance, the Employment Guarantee Scheme in Maharashtra, India – which provides employment to all those who want it – has encouraged farmers to take risks so that they plant higher-yielding and less drought-resistant crop varieties than farmers in neighbouring states. Insurance programmes that protect against specific risks such as low rainfall are currently being tested and may have similar impacts.

## … as well as encouraging the poor to make investments

Social protection, in the form of regular and predictable cash transfers, can encourage the poor to invest in businesses. Whether or not they are exposed to shocks, **cash transfers can provide the poor with the knowledge that their families will maintain a basic level of consumption**. As a result, they are likely to feel more secure and better able to plan for and invest in the future. **And, cash transfers can provide the means to make small investments.** For example, in the Oportunidades programme in Mexico, beneficiaries invest a quarter of the money they receive in small-scale enterprises and agricultural production. These investments are generating returns of between 32 per cent and 49 per cent.

Even the very poorest recipient families are able to use transfers for investment. For instance, in a pilot cash transfer programme in Zambia targeted at the poorest 10 per cent in the population – mainly female single-headed households and those headed by older people – 29 per cent of the money is being spent on chickens, goats and agricultural supplies. Similar investments have been made by recipients of the social pension in Namibia.

**It is particularly important that women have access to income and assets.** An inequitable allocation of resources within households can have a direct impact on productivity and can be an additional restraint on growth. For example, in Burkina Faso, agricultural production would increase by an estimated 10 to 20 per cent if women had equal access to farming supplies. One solution is to pay cash transfers

[5] *Insurance against Poverty*, Oxford University Press, 2004.

directly to women, as happens in Oportunidades in Mexico and throughout Latin America.

**Cash transfers in poor rural areas can also stimulate the development of local markets.** An injection of cash into relatively remote and underdeveloped areas can increase demand in the local area, and encourage businesses to invest in providing goods and services. The cash may well be spent on produce from the local area. For instance, in the Zambia pilot, 70 per cent of purchases were produced locally. At the moment there is anecdotal, but compelling, evidence of cash stimulating local markets, from rural areas of Brazil and countries in southern Africa, though more evidence is needed. Nevertheless, cash transfers hold a clear advantage over food aid – so often the intervention chosen by the international community to tackle chronic hunger – which tends to depress rather than stimulate local markets.

## Social transfers can help the poor participate more in the labour market …

A common objection to social protection in the form of cash transfers is that it reduces incentives for the poor to work, and leads to more inactivity. This can happen if the payment rate is high enough, as has been seen in developed countries, including the UK. It may be less likely in developing countries where transfer levels tend to be relatively low (though returns from working can also be low, especially in the informal sector). In fact, the evidence suggests **cash transfers may increase the participation of those out of work**, by helping them meet the costs of seeking work, such as buying new clothes and travel.

Although more evidence is needed on the impact of social transfers on the labour market, survey data from South Africa shows labour force participation increasing from 46 to 50 per cent for households receiving social grants over a six-month period, and staying unchanged at 70 per cent, for other households.[6] Tentative evidence from Brazil also shows a link between receipt of transfers and higher labour market participation.

Furthermore, cash transfers paid to extended – and dependent – family members, such as older parents or those living with disabilities, can reduce their dependence on those of working age. As a result, the working poor will be better-fed and healthier, and in a better position to meet the costs of seeking work.

In allowing those previously excluded to compete for jobs, **social protection helps to increase the flexibility of the labour market**. It also does this by protecting those who lose their jobs. Protecting the unemployed is a central function of social protection in developed countries, and has the added benefit of helping to build political support for change. For example, in South Korea, social protection was strengthened in the 1990s to win workers' support for the introduction of greater labour market flexibility, including significant numbers of lay-offs.

[6] We would expect participation rates to be higher for non-recipient households at all times as they contain fewer people that are poor, older people, and people living with disabilities.

## … and have an important role in easing the pain of economic transition

All economies undergo periods of transition to maintain their international competitiveness, such as opening borders more widely to trade or privatising state-owned enterprises. The process of adjustment will invariably create losers within the population, even though the country as a whole may benefit in the long term. **Social protection can support those who lose out during periods of transition**. As with reform in the labour market, it can help those who lose out to look after themselves and their families, until new opportunities arise.

**Without social protection, there is a higher potential for a breakdown in social cohesion.** When economies are going through a period of transition, or during any period of high or quickly rising inequality, a breakdown in social cohesion may lead to social unrest, as seen recently in Nepal and Bolivia. This can damage growth – people need a stable, secure and predictable environment to encourage them to work, save and invest. The same is true for foreign investors, who can pick and choose the countries into which they put their capital.

Developing countries are increasingly recognising the importance of social protection. In China, the government is responding to social unrest following job losses in state enterprises by, among other actions, increasing investment in social protection. Conditional cash transfer programmes are appearing throughout Latin America. Indonesia has introduced an unconditional cash transfer programme that reaches 18 million poor households, and in India, an employment guarantee programme is being introduced country-wide to support poor farmers. But social protection on a national scale is still relatively untried in poor countries in sub-Saharan Africa.

## Social protection must be financed …

All the potential benefits of social protection programmes, including their impact on poverty, need to be set against their cost, and financing for programmes needs to be found. But the cost should not be overstated. For example, a national programme providing support to the poorest 10 per cent of the population in sub-Saharan African countries could cost less than 3 per cent of government spending and less than 3 per cent of the additional aid agreed following the 2005 G8 meeting at Gleneagles.[7] However, even if the cost of national programmes is relatively low, **financing social protection will involve trade-offs**.

Higher taxes may reduce the incentive for taxpayers to be more productive. **Governments must be careful to strike a balance between preserving economic incentives and increasing social protection provision**. Higher taxes may also reduce savings, if taxpayers save a higher proportion of their income than the poor. This in turn can reduce investment and growth. On the other hand, redistributing wealth can also increase social cohesion and stability, as mentioned above, encouraging individuals – including the better-off – to work and invest. Also, the poor may be more likely to spend their income on locally produced (rather than imported) goods than the better-off, as has been seen in South Africa, which can have a

[7] *Can low-income countries in Africa afford social transfers?* (DFID Briefing Note, November 2005).

positive impact on growth. All the effects on growth, whether positive or negative, need to be taken into account.

## … and policy choices must be made

Even where social protection programmes have a net positive effect on growth, **there will be competing demands on available financial resources**, for example, to improve health, education, communications, and access to water. Alternative policy options that may be more cost-effective in meeting the government's objectives should of course be explored. However, social protection can effectively complement other policies, for example in health and education, and remains a relatively neglected policy area in many poor countries. Also, where social protection is being considered, **care must be taken over programme design**. In particular, there are likely to be significant challenges in deciding who to target and in ensuring there are incentives for beneficiaries to leave programmes, where this is appropriate. These issues are beyond the scope of this note, but a recent DFID practice paper discusses programme design in more detail.[8]

## But social protection can play a significant role in poverty reduction and growth

Social protection can help potentially productive people who are currently excluded from economic opportunities for reasons that have nothing to do with their individual capabilities. A basic level of support, for example through cash transfers, can give the poor the security to take risks with investments, to look for work, and to send their children to school. **Western governments already invest heavily in social protection, to protect the poor and help them participate in the economy.** Developing countries are increasingly recognising the role of social protection, though their spending remains relatively low, especially, as mentioned, in sub-Saharan Africa.[9] In countries with high levels of inequality – such as in Latin America and much of sub-Saharan Africa – social protection, along with broader social investment, is particularly important. High inequality reduces both growth and the impact of growth on poverty and, if inequality is not addressed, development will be set back.

There are, of course, many challenges to implementing programmes in poor countries, such as building political support and administrative capacity, and minimising the risk of corruption. DFID's practice paper on social transfers goes into more detail. But, if these challenges can be overcome, social protection has a potentially important role to play in achieving long-term, sustainable, and poverty-reducing growth.

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[8] *Social transfers and chronic poverty: emerging evidence and the challenge ahead* (DFID practice paper, October 2005).
[9] Spending as a proportion of GDP. *World Development Report 2006*.