

## Productive Role of Safety Nets

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Background Paper for the World Bank 2012–2022 Social Protection and Labor Strategy



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## Abstract

The paper contains a framework for linking social protection with growth and productivity, an updated review of the literature, new original work filling in gaps in the available evidence, and a discussion of operational implications. The paper demonstrates that there was a shift in the economists' view on social protection, and now they are seen as a force that can make a positive contribution towards economic growth AND reduce poverty. The paper looks at pathways in which social protection programs (social insurance and social assistance programs, as well as labor programs) can support better growth outcomes: (i) individual level (building and protecting human capital, and other productive assets, empowering poor individuals to invest or to adopt higher return strategies), (ii) local economy effects (enhancing community assets and infrastructure, positive spillovers from beneficiaries to non-beneficiaries), (iii) overall economy level (acting as stabilizers of aggregate demand, improving social cohesion and making growth-enhancing reforms more politically feasible). Most social protection programs affect growth through all of these pathways. But the evidence is very uneven; and there are knowledge gaps. The paper discusses operational implications for the design and implementation of SP programs and proposes a work program for addressing knowledge gaps.

**JEL Codes:** H55, I38, D61

**Key Words:** social protection, human capital, multiplier effects, pro-poor growth, risk mitigation

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## I. BACKGROUND, RATIONALE, AND OBJECTIVES

The role of social protection in preventing people entering into poverty, and in **reducing** the duration of **poverty** is well known.<sup>1</sup> For some time social protection has been recognized as instrumental to achieve greater **equality** (World Bank 2005a). More recently, experience has taught that when it is well designed, social protection can both redistribute the gains from growth and, at the same time, contribute to higher growth. The proponents of the new approach see **productive** contribution of social protection being as complementing its **redistributive** role and see social protection as an essential tool to achieve **pro-poor growth** (ILO 2005; OECD 2009; EC 2010).

Links between social protection and growth are present in the public debate around the world. Even in OECD economies with their extensive welfare systems the debate on social protection is framed around the questions of productivity ([www.oecd.org/social/ministerial](http://www.oecd.org/social/ministerial)).<sup>2</sup> It is argued that protecting households against shocks through social protection not only eases poverty momentarily but also enables growth by allowing poor and near-poor households to create and protect their assets, and allocate resources to risky but highly remunerative production activities (Holzmann et al. 2003). Similar views are revealed in country-specific policies: The Zambian government, for example, explicitly states that “*No meaningful and sustained economic growth can be achieved in the absence of social protection*” (Republic of Zambia 2006, p. 210; see also, Republic of Ghana 2005); United Republic of Tanzania 2008).

Yet it is still often argued that Low Income Countries (LICs) cannot afford to redistribute and should **instead** focus directly on growth in their spending allocations. And following this

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<sup>1</sup> In OECD countries, it is estimated that levels of poverty and inequality are nearly half of those that might be expected in the absence of such schemes (ILO 2010). Similar but smaller impacts have been observed in MIC countries; evaluations of *Bolsa Familia* (Brazil) and *Opportunidades* (Mexico), two large cash transfer programs show reductions of poverty gaps by 20% as opposed with 10% reduction attributed to smaller programs in other countries reported in IEG (2011).

<sup>2</sup> Most studies did not find any negative effect of higher social transfers on growth. For a systematic review, see Atkinson (1999), Lindert (2004); Arjona (2003); and Townsend (2009).

logic, many LICs are not prioritizing social protection in their poverty reduction and economic development plans. The limited traction of the “growth argument” for social protection in such countries is due in part to the lack of clear data on growth benefits properly assessed against costs. In addition to the fact that there are relatively few long term evaluations of full scale safety nets, there is a methodological challenge in aggregating the gains from multiple impact channels into a single straight estimate of benefits. There are real and important conduits between SP and long term economic performance (e.g., the welfare gains from reducing poverty and the effects of overcoming market failures or the promotion of social inclusion) but precise quantification of these is challenging (Sadoulet 2001).

In addition to still missing clear cut figures on how much growth an investment in SP brings, reluctance to consider safety nets as part of a growth strategy stems from concerns about possible perverse effects of social protection. Distortions created by fragmented and poorly coordinated social protection interventions may influence behavior of economic agents, discourage efforts, and lock beneficiaries into low productivity-low growth equilibrium (see for example, Levy 2007 for the case of Mexico as well as the literature review).

The new World Bank Social Protection and Labor Strategy aims to build a strategic framework for the Bank’s engagement in globally supporting the development of **effective** social protection **systems** over the next decade. This **Background Paper on Productive Role of Social Protection** is one of a series of background papers to inform the new strategy.

The current paper reviews the existing literature linking social protection with growth (see Annex), and analyzes which design features of social protection systems (or specific programs) enhance their productive effects. **The paper concludes that growth argument in favor of social protection is secondary to (and should not displace) the poverty reduction argument.** Based on this analysis, the paper discusses the implications for the Bank operations and suggests a work program to strengthen the knowledge base. The paper argues for increasing collection of evidence on growth impacts of SP, especially in LICs.

Systematizing data on cost and benefits of specific interventions can help to bring growth angle in the comparison of alternative forms of social protection and inform the strategic choices by the client countries. In undertaking this analysis, the paper takes a system-wide approach to social protection: social assistance (or safety nets in more narrow sense), social insurance (including pension systems, but also going beyond it by including protecting the access by the poor and vulnerable to essential services),<sup>3</sup> and labor market policies and programs. This paper provides a systematic summary of the literature including *all* forms of social protection (Annex).

## **II. WHAT DO WE KNOW ABOUT MAIN PATHWAYS FROM SOCIAL PROTECTION TO GROWTH?**

The Annex builds on the existing meta-studies (OECD 2006), Alderman and Hoddinott (2010), Barrientos and Scott (2008), IEG (2011), as well as other recent publications. Bringing together theories and practice, the general avenues whereby social protection can contribute to economic growth and poverty reduction are provided in the schematic way on Figure 1.

The various channels by which SP influences growth can be classified into three broad channels (from top to bottom of Figure 1):

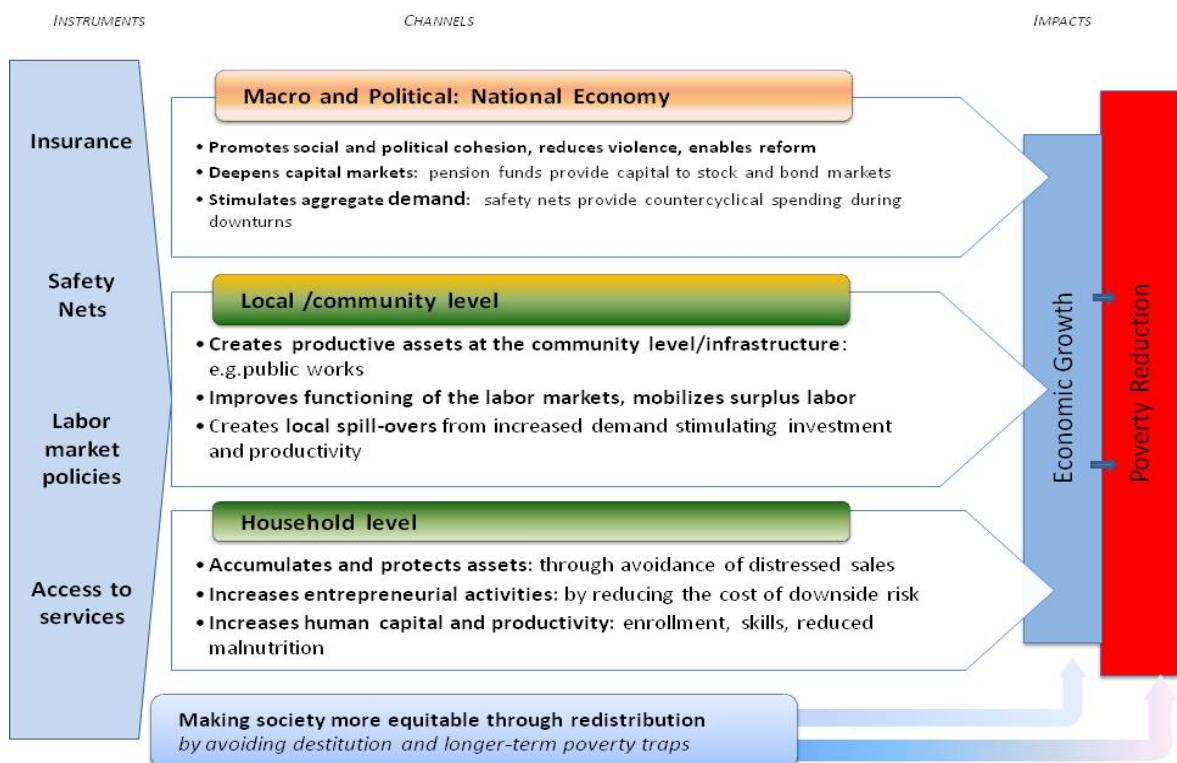
- I. Macro level effects; this level also includes political effects of SP (helping to achieve better economic outcomes by overcoming resistance to growth-enhancing reforms).
- II. Local economy level; that enhances the functioning of local economy (e.g. investment in asset base, improved operation of labor markets, and positive spillovers affecting non-participants in SP programs).

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<sup>3</sup> In that respect this definition is close to the EC standard, which also emphasizes “social inclusion efforts that enhance the capability of the marginalized to access social insurance and assistance” (EC2010). In this respect SP has a core function in securing access to services by vulnerable groups, such as disabled individuals.

- III. Household (or micro) level effects for participants of SP programs (occurring at the level of individual households); they stem from overcoming market failures by transfers (credit, inputs, insurance, and information asymmetries).

**Figure 1: Contribution of Social Protection to Productivity, Growth and Poverty Reduction**



Sources: Authors, adopted from van Domelen (2010)

Figure 1 depicts nine distinct channels through which SP programs affect growth. It also incorporates the **main** poverty reduction channel (at the very bottom), stemming from redistribution to the poor. Greater equality (achieved by SP interventions) can *itself* lead to higher growth (de Ferranti et al, 2000; World Bank 2005). Ultimately societies are less interested in growth as an end in itself relative to the concern with what is happening to incomes and their distribution. This is important in the context of poverty reduction since the poor have only a modest weight in aggregate income. Thus, appreciable increases in the

income of low income households may not be readily apparent in overall aggregate growth. The question of individual income gains from SP programs as opposed to aggregate growth is particularly relevant for transfer programs. It still is, however, germane for labor policies as well.

Figure 1 emphasizes a system-wide approach whereby social insurance, labor market programs, and social assistance interventions together are making a positive contribution towards economic growth. By providing households an income floor *ex ante*, so that they can diversify their investment choices in riskier/higher returns activities, social protection may help these households attain higher income trajectories. Any reliable and predictable social transfer, regardless of its “productivity” can play a role of such insurance, also affecting non-recipients. An additional “systemic” channel is represented in Figure 1 by regulations and institutions that provide social protection: they change conditions under which economic agents make their decisions.

In addition to these system-wide effects, there are also very direct links between social protection and growth in programs that are aimed at boosting the productive potential of their beneficiaries (e.g., active labor market programs or productive safety nets focused on enhancing the livelihoods of small farmers). Sometimes the broad question about the aggregate contribution of SP expenditures as a whole to the economic growth is mixed with a narrow question of “productivity” of specific social programs, particularly the possible contrast of consumption with more productive forms of social transfers. From a broader economic growth perspective this distinction is not useful. There are micro and macro pathways from all forms of social protection to growth, and these pathways are both direct and indirect. In what follows, while keeping the systems-wide view as the main focus, we also take stock of the evidence from “productive” programs.

Each of the SP programs is likely to have simultaneous effects along several channels, hence the difficulty of estimating growth effect empirically. The Annex offers a detailed

assessment of available empirical evidence on these channels, and shows that evidence is particularly strong for four channels:

- The evidence on human capital improvements leading to improved productivity and growth consists of a reasonably large body of material. Strong evidence exists on the impacts of conditional cash transfers and school feeding (effects on school attendance and utilization of health services); or on nutrition measures and their effect on reducing malnutrition. These observed outcomes are often linked to expected future net income growth.<sup>4</sup>
- Influence investments decision by changing incentives: social protection stimulates investment by substituting for missing or inadequate credit markets. Cash transfers, conditional or otherwise, can facilitate job search or timely purchases of agricultural inputs. They may also encourage investments in health and education for which it is generally difficult to obtain credit.
- For reforms of pension systems and labor market regulations, there are well-known impacts on economic growth (positive or negative depending on the design of systems). However, these tend to be small.
- For local/community level effects, there is fast-growing (but still nascent) literature on the linkages between SP programs of various kinds and local spillover effects: through transfers between participants and non-participants, increased demand, and improved matching to jobs.

Additional channels exits but some of these are difficult to assess with any precision. For example, attributing a precise share of higher growth stemming from social peace or reform facilitation to SP is difficult if not impossible to assess.

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<sup>4</sup> The precise effect of improved human capital on aggregate growth is still difficult to quantify. See Weil (2007) for the most recent account for impacts of improved health on growth, presenting a very wide range of plausible estimates.

Less evidence is available for comparative magnitude of costs and benefits of **different** SP instruments assessed from the economic growth viewpoint.<sup>5</sup> Rigorous impact evaluations can provide quantitative estimates of program impacts that can be used to carry out more precise comparisons of benefits and costs of alternatives. Multiple channels of impact, the numerous interactions between SP programs, and the nature of the benefits (long term) often make it challenging to accurately measure and quantify impacts. Little is known and even less is used when it comes to the overall economy-wide impacts of SP systems. Most of the transmission mechanisms listed on Figure 1 work at the micro or meso level. While in sum the contribution can be important, it is not clear to what extent this might lead to a measurable macro-economic impact. Table 1 below lists some available evidence.

Overall, there is clearly a positive contribution from social protection programs to economic growth. But the return on investment in social protection cannot justify **by itself** the claim for limited public funds: there are more productive forms of government spending. For example, for social protection projects an **economic** internal rate of return between 8% and 17% is typical, while the median rate of return for all sectors is about 25% (for all Bank projects across all sectors for which it was estimated over 2005-07 (Warner 2010)). What makes social protection more desirable than other forms of spending is their strong direct effect on poverty reduction that is, social benefits. We return to this critical point below.

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<sup>5</sup> A recent contribution to this field is found in Hodges, White, and Greenslade (2011).

**Table 1: Summary of Estimates for Growth Impact of Social Protection:  
Micro, Meso, and Macro Level**

<b>Country/ Level Program/Type</b>	<b>Method</b>	<b>Results</b>	<b>Study</b>
Cross-country/ macro-	All SP spending	Regression	Moving from 0 to 2% of GDP spending on SP increases growth by 0.1-0.4 pp
South Africa/ macro-	<i>Gundo Lashu and EPWP/PW</i>	SAM	Labor intensive PW on the scale of 0.2% of GDP increases GDP by 0.34%
US/macro-	2009 Stimulus package	Modeling	Multiplier for expansion of the food stamp program is 1.7, larger than for infrastructure spending (1.6)
Representative econ./ macro-	Fully Funded (FF) Pensions	Simulations	Moving from PAYG to FF pensions increases GDP by 3-5% in 110 years
Bangladesh/ macro-	BRAC/Ruraldevelopment-Micro-credit	SAM	BRAC was boosting GDP by 1.15% in 1998 while its cost was 0.2% of GDP
Brazil/ meso	<i>Bolsa familia/ CCT</i>	Regressions	10% increase in the program increases municipal GDP by 0.6%, B/C=3.5
India/ meso	<i>NREGA/ PW</i>	Simulations/ SAM	Public works in a village increase HH incomes with a multiplier of 1.77
Malawi/meso	Dowa Emergency Cash Transfer (DECT) /CT	Simplified SAM	Total multiplier effects of the DECT between 2.02 and 2.79
Lesotho/meso	Child Grants (CGP)/CT	Full village SAM	Total multiplier effects of the CGP between 1.17 and 2.43
China/micro	Southwest China Poverty Reduction/CT	ERR	ERR = 8.6-9.8% (lower bound)
Bangladesh/ micro	Food for Education (FFE)/ SF	ERR	ERR = 15-24%
Colombia/ Micro	<i>Familias en Accion/CCT</i>	B/C	Benefit-cost ratio = 1.59
Mexico/ micro	<i>PROCAPMO/CT</i>	B/C	Benefit-cost ratio = 2.5
Mexico/ micro	<i>Oportunidades/CCT</i>	ERR	ERR = 8%/year (lower bound); 17% (higher bound)
Ethiopia/ micro	Productive Safety Net Program/PW	B/C	Benefit-cost ratio = 1.8-3.7 (depending on the subproject)
South Africa/ micro	Child Support Grant/ CT	B/C	Benefit-cost ratio = 3.3-4.5
Chile/ micro	Progressive Housing Program/Subsidy	ERR	ERR = 18%, much higher than country's official cut off rate of 12%

Source: IEG 2011 for micro impacts of SSN, Hodge et al 201; authors compilation for all other programs based on Annex. Notes: pp- percentage points, PAYG-pay as you go pension, CT- cash transfer, CCT- conditional cash transfer, ERR- economic rate of return, B/C- benefits to cost ratio, SAM –social accounting matrices, SF-School feeding, PW-public works.

There are a few **theoretical** models that help to conceptualize the economic cost and benefits. They are including presence of SP instruments as a parameter influencing decisions of key economic agents and hence overall economic performance (e.g., Levy 2006; Banerjee and Duflo 2009; Sala-i-Martin 1995; Devarajan and Jack 2007). But these models of

impacts are often complicated for policy audiences and do not contain clear cut answers to the basic question on returns from investing in Social Protection.

Compensating these shortcomings, cross-country data analysis aims at providing such direct answers. Abstracting from each individual channel, these studies ask a question by how much overall SP spending would affect growth (controlling for a group of other factors which influence growth rates). Zaman and Tiwari (forthcoming), use IMF data on SP spending from over 100 countries spanning 1980-2008 and arrive to the conclusion that SP positively influences economic growth. But these studies are also not very practical in terms of helping to identify which forms of SP are particularly “productive” in each specific case.

Figure 1 presents “positive” avenues of SP effects on growth. There are also possible negative feedback loops. Some, like distortions associated with taxes to finance programs, are not specific to SP while others, such as any disincentives for work arising from receipt of unearned benefits or mobility constraints (e.g., associated with employment protection (EP) legislation), are. In the world of second best choices, distortions associated with SP do not appear as major efficiency losses (Lindert 2007; Arjona et al. 2003). However, a few studies (Levy 2007; Sahn and Alderman 1996) do find negative effects even in developing countries context; lessons from such (scarce) negative evidence can be particularly useful to design programs which minimize distortions.

Even when there are well-documented, positive effects on income growth or accumulation of assets among participants, it remains unclear by **how much** these interventions can contribute to the economic growth at the level of the country. Therefore, it is a rare case when the cost and benefits for SP programs are presented and compared. Only a handful of studies as Table 1 shows estimate costs and convert findings into rates of returns that can be used to compare alternative interventions. Again, we stress that the difficulty of quantifying the benefit of transferring consumption from the average consumer to the poor is an obstacle to estimating rates of return, although most economists would concur accept

the theoretic models that underpin such estimates (see, for example, Deaton 1997, Sections III and V).

However, the relative weakness of evidence in support of growth-enhancing the potential of social protection should not be overemphasized. In fact, the growth literature itself has failed to produce clear cut recipes on how to spark growth.<sup>6</sup> What is missing is not so much the solid evidence on the impacts of SP programs on income growth, particularly at the individual and household level, but clarity on practical steps to apply this perspective in practice.

### **III. HOW PRODUCTIVE POTENTIAL OF SOCIAL PROTECTION IS USED IN PRACTICE?**

The literature on the growth impact of SP is very rich (although uneven), but the practical application of the idea has clearly lagged behind (see Annex for detailed illustrative examples). Many pieces of scientific evidence are based on small scale pilots, with uncertain scalability at the country level (ODI 2010).

Justifying SP spending by its contribution to the growth agenda in addition to its readily apparent role in poverty reduction can be a way for the development partners to help expand support for social protection. Yet, the Independent Evaluation Group (IEG) (2011) finds that no growth argument was used to encourage the adoption of SP in as many as 40% of the cases of World Bank country programs examined over 2000-2010.

This practice is in striking contrasts to other human development (HD) interventions. For example, growth arguments and benefits over costs ratio are used prominently in arguing the case for nutrition policies and programs, even though they are based on a limited number of (but carefully done) studies (Horton et al. 2010; Alderman and Behrman 2004). The same can be said about returns to human capital as an argument for education

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<sup>6</sup> Banerjee (2008) eloquently argues that, precise policies aimed at sparking direct growth consistently fail across the developing world. He emphasizes the role of enabling conditions (rather than direct stimulation), among which social protection against risks is an important one.

spending (Wigley and Akkoyunlu-Wigley 2008). For social protection, scientific material abounds but is not well marshaled into a toolbox with clear cut calculations.

In practice, decisions over reforming SP systems, even when growth benefits are known, are informed by other objectives, such as fiscal considerations. Seldom are specific growth objectives set or the path altered to strive for greater growth impacts.

Pension reform is a good example of gaps between theory and practice. Many simulation techniques are available to estimate the effects on macro-economic variables from different scenarios of reform (see ILO 2011; Corsetti and Schmidt-Hebbel 1995).<sup>7</sup> Empirical studies assessing the impact of different institutional provisions for pensions on behavior of economic agents have only recently become possible (Hurd et al. 2008). Hence, demonstration effects and informed beliefs play as big a role in practice as the theoretical insights. With a downside that they do not enjoy balanced objective performance assessments and may become challenged as a result of changing beliefs.

The example of Chile (which launched its pension reform in 1981 and has had a very good growth record since) inspired 11 countries in Latin America to include mandatory savings tiers in their pension systems. The first wave of such systemic reforms in Latin America was followed by reforms in 13 countries in Central and Eastern Europe and Central Asia, some of which were hardly hit by the 2008 global crisis (ILO 2011). None of the countries that followed the Chilean model had similar stellar performance in growth, for reasons most likely not related to pension reform choices.

Practice could also be getting ahead of any theory and research. The example here is the use of social protection in making complex reforms politically acceptable and as a builder of social cohesion in post-conflict societies (see Annex for a wide range of examples). The instrumental role of SP in supporting reforms of subsidies is well documented (G20 2011), but no one so far has been able to say: (i) how much growth benefit such reforms bring

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<sup>7</sup> To note however, is that these models display small magnitude of effects: it is not unusual to find that output level will be higher or lower by 2-3% in 100 years time – hardly a factor for policy decisions (Arjona 2003).

about and what is the “share” of SP in this incremental growth; and (ii) how much SP spending and which form is sufficient to make reforms politically and socially acceptable.

Labor market policies especially in developed countries have been designed and adjusted with substantive input from researchers, experiments, and studies (Betcherman et al. 2004; Auer et al. 2008; Fields 2007). Practice and theory seem to go hand-in-hand in the SP programs aimed at asset creation – both at the community and household level. There is a parallel effort in building good business models and conduct evaluations (for the community level through public works (WB and ILO), for household the level through a CGAP initiative on improving access of the poor to financial services and other micro-finance innovations (see Hasemi 2007; CGAP 2001. More details on the BRAC model of asset creation are provided in Almeida et al. (2012)). Practice and studies also go hand-in-hand around food-based interventions (change in food aid modalities promoting local supplies, school feeding based on home grown supply), largely inspired by the nutrition and early childhood development literature (see WFP 2011; Brinkman 2007).

The productivity-enhancing role of social protection depends on sound system design, efficient administration, and good governance. Apparently the institutional arrangements that govern the transfers can create micro-economic incentives as well as disincentives and inefficiencies. Social expenditure, thus, may facilitate high levels of GDP through the productivity conduit but it may not lead to a full exploitation of countries’ production potential if badly designed. One key issue for the future will be to discern between good and bad design of social protection systems (see Robalino et al. 2012).

#### **IV. LESSONS LEARNED AND GAPS TO BE ADDRESSED**

Overall, as Sections II and III have demonstrated, there is substantial (yet patchy and uneven) empirical evidence informing current practices. Returning now to the channels of impact and looking at the sheer number and robustness of studies, as well as the richness of instruments and country experiences, we can rate the evidence and practice for each

channel from strong and active (★★★★★) to weak (★). This is, of course, highly subjective and relative, but this is precisely our aim here to identify the parts of the practice that are apparently weaker than other parts and try to understand why.

**Table 2: Productive Impact of SP: Strengths and Weaknesses of Evidence and Current Practice**

Effect	Strength of Evidence	How Good is Current Practice?
	From ★★★★★ Strong to ★ Weak	
<b>Micro: enables households to invest</b> -In human capital -In other HH productive assets and savings -In higher risk/higher return activities	★★★★★ ★★★ ★ ★	★★★★ ★★★ ★
<b>Meso: local economy effects</b> -Investment in productive community assets -Increased demand and local spillovers -Addresses labor markets failures	★★ ★★ ★★★★★	★★ ★ ★ ★★★
<b>Macro and political economy effects (indirect)</b> -Automatic stabilizers/multipliers -Increases savings/improves resource availability -Allow governments to enact reforms -Improve social cohesion/reduce crime	★ ★★★ ★ ★	★ ★ ★★★ ★ ★

Source: See Annex for detailed references and discussion; the rating criteria and framework are adopted from Grosh et al. (2008).

Some areas of SP practice have accumulated solid evidence that is informing the practice: investment in human capital (conditional and unconditional cash transfers, school feeding, early childhood development, and nutrition), building household assets (micro-credit and saving schemes), and labor market progress (especially ALMPs). There are also areas where practice is rich and growing and is ahead of research evidence or the scant codified knowledge: actively using the conflict reduction pathway of SP, and using of SP to promote reforms.

There are three areas where both theory and practice are particularly limited: (i) the use of safety nets as a means to insure households in order to stimulate more productive, but riskier, activities and entrepreneurship; (ii) the conscious use of local spillovers and ensuring economic value of local infrastructure created by SP interventions (e.g., in public works); and (iii) the use of SP for boosting overall economic growth and stabilizing the demand in times of crisis.

The absence of operational ways to use the productivity-enhancing potential of safety nets or other social protection instruments to promote entrepreneurship and better resource allocation is a particularly glaring limitation. In the best case, only general principles of risk reduction framework are applied at the stage of design (e.g., PSNP in Ethiopia),<sup>8</sup> but no specific quantitative benchmarks are used. More specifically, the trade-offs between poverty reduction objectives of safety net programs or of wider SP initiatives and their role in promoting growth is seldom made explicit. Targeting criteria, for example, will differ in programs designed solely to reduce poverty compared to those that are designed to reduce income variability (Sumarto, Suryahadi, and Pritchett 2003) or those that aim to raise the incomes of low income households.

Choices between the first and the third objective, for example, will consider the labor availability in the household and potential for investments, including investments in schooling or health. In this particular example, if the only goal was to raise incomes within the subset of low income rural families, the optimal solution would be to target beneficiaries of such programs based on their marginal productivity. This may have a bearing on the targeting weight given to landless households relative to small farmers. But many SP targeting instruments are not designed to assess potential productivity. In practice, many productive SP programs have mixed or multiple objectives and thus have mixed results. The greater problem, though, is that the relative weights placed on these objectives

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<sup>8</sup> The main principle is predictability of transfers over time, which is dealt with by qualifying participants for a sufficiently long period of time (e.g., five years in the case of Ethiopia). This is based on the assumption of transparent and regular transfers.

are not overt and, thus, projects may be assessed on criteria that may differ from the goals (see Lei Pan and Christiaensen 2011).

Another area where we have serious gaps is integration of social assistance and social insurance. Theoretical case for insurance function of safety nets or social protection more broadly is summarized by Devarajan and Jack 2007. But rarely insurance function of safety nets is put forward. In practice, in some MICs access to poverty-targeted programs also triggers access to insurance (e.g., access to subsidized health insurance to social assistance recipients in ECA). This model has proven to be fiscally costly, but it is being used now in LICs or MICs with nascent SP systems (e.g., Ghana's LEAP program or Morocco's current experiment with free health insurance). This is serious challenge requiring close collaboration between social protection and public health specialists (see Robalino et al. 2012 for in-depth discussion of implications).

Almost every SP instrument works through multiple channels of impact, direct and indirect; therefore weakness of theory and practice in some areas means that we are not capable to fully represent the benefits of SP for growth and do not fully master the use of SP as growth-promoting policy. And even in cases where our practice and theory are strong, there are still many gaps in terms of the longer term (lifelong) impact on beneficiaries (IEG 2011).

Based on this assessment, the proposed work program aims at filling the gap regarding micro- and macro-economic assessment of returns to social protection spending. The main gap that we see so far is scarcity of cost and benefit estimations for SP as a whole and for its components. Rare examples cited in Table 1 in the previous section are not widely used. What are reasons for this apparent failure?

Detailed discussion in the Annex shows that it is indeed a formidable challenge to come up with a robust and clear cut assessment of an SP program from the economic growth perspective. Given the difficulty, should we abandon as a practice the attempts to do so? No, for three reasons:

First, the example of nutrition, which was able to make an effective case for scaling up based on comparatively small scale or localized evidence often with randomized control trials, should be inspiring and empowering. Going beyond advocacy, we also need to be able show what specific features of SP systems have greater effects on growth stemming from long term/ system-wide effects and cross-sectoral links (e.g., agriculture and nutrition). There are missing pieces of the puzzle here. Elbers et al. (2007), for example, using panel data from Zimbabwe, show that rural households accumulate almost 50% less capital in the face of greater risks thereby lowering both the level of per capita income while increasing income volatility. Risk mitigation schemes will dramatically raise growth rates and reduce the volatility of growth by a significant amount. Careful empirical work based on policy interventions to reduce exposure to risk or promote insurance or credit may therefore provide missing evidence on the critically important channel for potential benefits.

Second, as mentioned, cost-effectiveness calculation may be extremely practical when comparing alternative programs of SP or alternative designs of SP instruments. The evidence on the potential full economic impact of programs for beneficiaries and non-beneficiaries alike and evidence on the channels through which these impacts are realized, would allow policymakers to compare these programs with other programs that compete for tight fiscal resources. Therefore it is necessary to address gaps as portrayed by Table 2 not to come up with final aggregated estimate but to be able to compare and weigh alternatives.

Third, there are new opportunities that could facilitate the progress, and increased demands for inclusion of productive aspects into design of social protection interventions. These are outlined below.

## V. NEW CHALLENGE AND OPPORTUNITIES

There are new developments that increase the importance of incorporating the productive role of safety nets into the current practice at the World Bank and with partners. Greater **demand** from clients for SP instruments that promote overall growth or tilt growth benefits towards the poor comes along several avenues:

- We are witnessing unprecedented global consensus around social protection as a factor of pro-poor growth. This renewed interest both provides a stream of projects that can become the source of new evidence enriching the global knowledge base and at the same time, the spate of investments increases the value of evidence on how growth-promoting productive social protection can be most effectively achieved.
- Many middle income countries are emphasizing activation agenda for SP recipients and look for design of SP programs (ALPMs more narrowly, but incentives in their systems of social transfers more broadly) to directly improve productivity and employability of their participants. Again, this increased emphasis enhances the value of sound evidence.
- Recent string of financial, fuel and food crises put an emphasis on stabilizing role of SP over the economic cycle; countries are interested in designing social protection programs that will both address chronic poverty and contain scalable/flexible programs:
  - Countries are learning from recent experience with scaling up CCTs in LAC, which pushed the boundaries of this instrument from a focus on chronically poor to those vulnerable to crisis, and from long term development investment into a short term stabilization scheme. The need to adapt instruments to new circumstances also made many countries acutely aware of the limitations of the instruments that they had available. SMART social protection agenda in ECA (designing

incentives compatible, flexible programs leading to promotion) will remain the vector for the development of SP in the region, with lessons to be learned.

- Innovative solutions coming from extending social insurance programs (especially unemployment benefits, but also health insurance) to high informality countries (see Dorfman et al 2012).
- The new lessons learned from scaling up public works in response to the global financial crisis both in MICs and LICs, their role in targeting crisis vulnerable households, while providing productive employment and income support.
- Political economy of moving from fuel and food subsidies into targeted programs requires greater attention to economic benefits of SP, which could at times compensate for economically (and socially) painful removal of subsidies (needed to improve efficiency and reduce waste of non-renewable resources). This agenda is particularly prominent in MENA, South Asia, Africa and EAP.
- Crime/social cohesion and investment climate effects of extending SP programs are being seriously explored by many countries (especially in context of youth programs in countries with youth bulge or post-conflict). There is a great demand for presenting them as investor-, innovation- and growth- friendly interventions.

Providing practical directions on how to use growth-enhancing potential of social protection might help to build broader alliances in support of social protection reforms and achieve pro-poor growth objectives. There is also a need to examine possible negative interactions within SP to minimize distortions.

In addition to greater demand for growth-enhancing SP policies, other factors will increase our capacity (**supply**) to fill in gaps and generate answers to policy questions. The main change is that we are living in an era of major innovation for social protection programs, both in the developed world and in the developing world:

- *Ongoing CCT programs are reaching the stage of maturity.* It is now possible to conduct empirical studies on long term effects of these programs on the growth of beneficiaries' incomes. Improved documentation and data collection (including administrative data), which was part and parcel of instituting the CCTs, will allow us to make longitudinal studies on unprecedented scale and with so far unattainable precision.
- *New "productive safety nets" (e.g., Public Works+, micro-credit, nutrition (e.g., fortification), small farmer livelihoods development) aimed at boosting the productive potential of their beneficiaries are increasingly popular around the world.* The largest SP program in Africa, PSNP in Ethiopia, is using an integrated set of interventions to promote productivity and resilience of rural livelihoods. Its evaluation is already giving important insights into the design and implementation of such interventions. There will be more evidence coming from various impact evaluations sponsored by ILO, FAO, and SIEF.
- *A marked shift has occurred in donor assistance to safety nets in favor of interventions that stimulate local food production* (WFP 2010; EU 2011; Andrews et al. 2011). Monitoring of economic impacts and local spillovers is an intrinsic part of evaluations of these programs. It will greatly enhance the knowledge base about design aspects that favor growth effects.
- *The social floor agenda has some uptake.* Its advocates are providing economic rationale for universal social assistance programs, and countries which adopted social pensions (OVC), especially in Africa, are aiming to produce evidence about their positive indirect effects on economic development.
- *Integrated systems and programs that work across sectoral boundaries are receiving increasing attention.* There are increased synergies between social transfers and other sectoral programs due in part to the PRSP, in part to the work on improved governance, transparency, and new fiscal rules. Agencies are aiming to collect more evidence on impacts (e.g., to compare fertilizer subsidies and cash transfers). For

example, DFID has recently invested in detailed guidance for using the concept “value for money” in SP projects (Hodges et al 2011).

- *SP programs are regarded as an entry point into financial access for the poor.* This is a rapidly evolving agenda where some major donor rally behind financial inclusion aspects of SP that are expected to dramatically increase access to financial services by so far excluded groups and hence improve resource flow and overall economic performance.
- *Improved IT facilitates the delivery of cash and for monitoring results.* It also facilitates the linkage of safety nets with financial services.

These changes would allow the global practice to move to the new level of awareness and practical use of economic benefit and costs in SP programs. They will also help overcome the barrier that estimates of costs and benefits are not easily transposed from one context and country to another: broadening the coverage of countries and contexts will make the evidence more robust.

Using already-available evidence, some specific features of project design could enhance productive effects of social protection interventions. **General principles of growth maximizing social protection systems will not be that different from principles for constructing an effective and efficient SP system** (see Robalino et al. 2012). There are also steps that need to be made in the coming ten years to make productive focus more effective and more consciously used in practice:

- I. Enrich current practice in the existing instrument of SP&L by emphasizing new growth-enhancing elements:
  - a. For any cash transfer program, carefully consider introducing linkages with other financial services including enhanced access to savings instruments as well as actuarially fair insurance as part of the package when it leads to improved outcomes and is fiscally sustainable.

- b. For public works, local development/ CDD programs: ensure economic value of assets created by including adequate funding for non-wage components and active involvement of local communities in planning.
  - c. For school feeding programs: consider designs which promote local procurement and generate economic spill overs in the participating communities.
  - d. For agricultural livelihood development programs: incorporate risk-mitigation and insurance features, develop new instruments to target based on the proxies for marginal productivity.
  - e. For microcredit and financial inclusion programs (focused on graduation): ensure consistency with economic development paths and enhance local spillovers.
  - f. For conditional cash transfers: they have proven to be effective in creating preconditions for enhanced human capital, but the new generation of programs is focusing on improving learning and health outcomes and by establishing cross-sectorial linkages.
  - g. For insurance programs: avoid distortion of incentives due to inconsistencies between different regimes; integrate insurance more closely with financial inclusion programs and other transfer payments. This includes assisting with the design of flexible financial instruments as well as a layered approach to insurance with targeted subsidies where – and only where – appropriate.
  - h. For labor market programs: see Almeida et al. (2012).
- II. Use economic cost-benefit analysis where appropriate and cost-effectiveness studies to inform the design of SP programs (e.g., duration and size of benefits, conditionalities, provision of productive services to beneficiaries), and their evaluations.

- III. Apply cross-sectoral design and use of systems approach to enhance the positive synergies and minimize distortions through integration (where possible) of activation principles and instruments into the design of SP programs. Closer integration of social protection programs into the work of line ministries outside of social protection, especially investment, agricultural development, health, transportation, environment, employment and youth, and water and sanitation.
- IV. Capture growth benefits in the **monitoring and evaluation**. This implies primarily focusing on the net income growth of beneficiaries of SP both in the short and long term. Systematic collection and packaging of available evidence on growth impacts of individual projects and systems, production of good practices and toolkits.
- V. Application of macro-economic tools (SAM and simulations) for the LICs to understand and assess overall and local economic impacts of investment in social protection, and of large scale programs (e.g., pensions, public works, and CCTs).
- VI. Don't oversell the productive dimension of SP. In many circumstances its primary function is to raise consumption of the poor. If the complementary role in asset creation and human capital investment is presented as primary SP programs will be judged on that criteria.

These steps to mainstream growth-enhancing social protection require readjustment and reorientation to the way the World Bank does business in social protection and labor. They will be informed by the new knowledge that is becoming operational part of the agenda. For the World Bank teams, it is unfeasible to try to fill all gaps. Moreover, there are many other areas in SP where we face new challenges and opportunities and have to respond to new demands; the growth-enhancing focus is not the only one. Strategic choices therefore need to be made.

## VI. STRATEGIC CHOICES AND DIRECTIONS FOR THE WORLD BANK, AND AN AGENDA FOR FUTURE WORK

The ultimate objective to bring in the productivity angle to the social protection is beyond advocacy. Tools need to be developed to assess alternatives for SP systems (in particular in poor countries) based on their comparative costs (both budgetary and transactional) and benefits. We should help our client countries find the most productive way to invest in their SP systems.

Taking what is already known, we can identify areas of our work where we should do more or maintain the level of efforts, and propose to change some approaches (which were developed in a different context) to align the social protection and labor practice with the pro-poor growth agenda. These proposed changes are listed below for three types of actors/level of decision-making: (i) global practice comprising SP agencies in client countries and major donors working on the social protection agenda; (ii) the SP and labor practice at the World Bank comprising SP regional teams and teams from other sectors working on SP products or engaged into the dialogue on SP issues, (iii) Human Development network anchor.

What should we do **as global practice** to make a case for the productive role of social protection and encourage its greater application around the world? The development partners and actors of social protection policies around the world can make the following changes to achieve greater growth benefits from SP:

- Shift resources towards supporting poverty-reducing and equity-enhancing SP programs with the largest growth benefits.
- Advocate and support SP programs with integrated design including productive sectors (e.g., integration of public works into public investment, alignment between agricultural policies and social protection programs).
- Support further development of CCTs with a focus on human development outcomes and results.

- Enhance our handle on growth-promoting risk mitigation/insurance schemes that avoid moral hazard problem and foster more innovation; build bridges between SP and micro-finance/financial inclusion community to enhance growth and promotion aspects and targeting of new interventions.

What needs to be discarded/changed:

- SP practice should avoid framing SP interventions within the dilemma of equity or efficiency, instead it should emphasize the efficiency-enhancing nature of well-designed social protection.
- The proponents of SP should avoid labeling certain SP programs as “productive” or “promotion-focused ” since this indirectly implies that others are not productive or do not aim at promotion.
- SP practice may benefit from changing the view of SP insurance instruments as purely risk management or financial security tools, towards a view that they are also growth-enhancing.

What should we do as the **SP Network of the World Bank to foster investment in social protection with higher returns**? The agenda will closely follow what we propose to do as global practice, but will address our comparative advantages as the World Bank Group working with MIC and LIC clients within country-driven processes. What do we keep/increase?

- Identify types of projects and design aspects that enhance growth benefits and use them across regions. In LICs focus on developing a new generation of livelihood projects with alignment between agricultural, nutrition, and social protection components.
- Systematizing knowledge in countries experimenting with the new generation of CCTs with a focus on human development outcomes and in partnership with health and education networks.

- Develop a joint program of work with the private sector development network on developing risk mitigation programs for small producers with enhanced growth and promotion.
- Develop with the Agriculture and Rural Development Network (ARD) a new methodology to robustly target beneficiaries of input subsidies based on marginal productivity.
- Emphasize new analytical studies and impact evaluations for types of social protection where the evidence is thin: insurance/risk mitigation schemes, public works (especially their infrastructure dimension).
- Develop good practices to define graduation objectives for beneficiaries of SP projects.
- Diagnose incentives and distortions in SP systems that lead to lower growth.
- Mainstream estimation of net income growth effects into impact evaluations in LICs.
- Reach an improved understanding of the political economy underlying growth-enhancing moves from subsidies into targeted SP systems.
- Keep or expand the role of SP practices in policy dialogues on growth-enhancing reform of subsidies into targeted SP systems.
- Improve the methodology for including distributional benefits in cost benefit calculations.

What needs to be discarded/changed:

- We should not resist to produce rough estimates of growth effects of SP, so long as we use the consistent framework and common reference/ benchmarks and offer sensitivity analysis of the key assumptions used.
- We should overcome our internal divisions, especially when it comes to insurance programs and develop good practices (between SP, health, and finance).

- We should not take graduation/exit objectives in the design of SP as arbitrary or driven by political rationale; instead we should aim at providing realistic targets to our clients.
- We should overcome short term frames (3-5 years) for monitoring results of projects.

What we will do as the **HDNSP** to support and facilitate these actions? The agenda for productive social protection is knowledge driven. It also needs cross-sectoral cooperation. Hence, the HD anchor's role is important. HDNSP should pay more attention to specific aspects or develop new resources as outlined below:

- Produce and test checklists to enhance growth benefits of the main types of SP projects (e.g., conditional cash transfers, public works, school feeding, and social funds); develop results frameworks for projects that include productivity indicators.
- Contribute to the development of new proxy targeting methods based on marginal productivity of subsidized inputs.
- Make readily available and constantly updated evidence on growth benefits of SP&L across the world drawing on existing studies, reports, modeling (with PREM), and impact evaluations that provide internal rates of return or cost/benefit analysis on SP investments.
- Update SP spending data across countries, guide data collection in household surveys to improve collection of data on income growth and accumulation of productive assets, and influence modeling for LICs.
- Support initiatives aimed at conducting in-depth long term tracer studies of program participants (with Development Economics); systematically assemble the evidence on such impacts.

As some of these activities are new and/or require more inputs, to make a space for the innovative work we also need to discard or change certain aspects of Anchor's work. But it is hard to see what part of our business the new focus on productive social protection will

replace; most often it will simply add a new angle of what we do anyway. However, certain aspects of our work can change:

- We should not discriminate against growth analysis of SP interventions based on a limited evidence base or unresolved issues. The base will remain weaker than we would like to see it, and debate will go on.
- We should not see productive social protection as special forms of interventions alongside others (e.g., public works or fertilizer subsidy), but instead promote the view of the productive nature of SP overall; especially we should dispel the myth that social assistance to the very poor who lack any assets, or the disabled and elderly, necessarily has no growth benefits because the recipients are not able to work or increase their productivity. Instead, we should carefully assemble evidence for potential indirect growth impacts.
- We should not consider small effects from SP on growth as a sign of its “unproductive” nature.

**Results: what we expect to achieve?** Table 3 gives a snapshot on the possible results matrix.

**Table 3: Results from Integrating Productivity – Focused Approach into Social Protection**

<b>Globally:</b>	<b>At The Country Level:</b>	<b>From Our Bank Work:</b>
<ul style="list-style-type: none"> <li>• More interest and support to SP systems with productive focus among donors and international agencies</li> <li>• Change in the design of aid and development projects to focus on promoting local sustainable growth,</li> <li>• Overcoming the view of SP as one side (redistribution only) within the equity/efficiency tradeoff</li> </ul>	<ul style="list-style-type: none"> <li>• Core economic ministries are more involved in SP reform strategies,</li> <li>• SP is regarded as productive investment and not as a residual spending priority</li> <li>• The role of SP as macroeconomic stabilizer is consciously used,</li> <li>• M&amp;E trace productivity related indicators for SP programs for beneficiaries,</li> <li>• Experiments with new forms of productivity enhancing SP design (activation, micro-credit, insurance etc.)</li> <li>• Better accounting of the value-added of the assets created of public works programs</li> <li>• More incentive compatible architecture of SP systems is applied in practice</li> </ul>	<ul style="list-style-type: none"> <li>• The staff is aware of the productive role of SP and specific features of project design which enhance productive effects;</li> <li>• Better alignment of HD and PREM teams specifically in fiscal policy discussion and policy reform aimed at improved public expenditure management and allocation</li> <li>• New tools for including productivity related indicators into SP M&amp;E at the project level exist and are used;</li> <li>• Teams conducting dialogue on SP are equipped with most recent evidence and data on productive role of SP;</li> <li>• The academic community is encouraged to conduct more studies that demonstrate productive role of safety nets and capture longer term income growth of SP beneficiaries;</li> <li>• New LIC clients are borrowing for SP projects with productivity enhancing elements</li> </ul>

## VII. CONCLUSIONS

This paper presented a review of studies and assessed the current practices engaging productive contribution of social protection to economic growth. The paper aimed to answer three clusters of questions:

1. Do we know how social protection affects economic growth? Do we know enough?
2. Would better knowledge on growth benefit help to make a case for SP, especially where a case needs to be made (in LICs)? Where do we need to invest in knowledge about growth benefits of social protection?

3. How as a practice we should evolve to mainstream the use of growth impacts of SP in the work on SP programs? What should we do more? What should we do less?

The paper shows that the frontier regarding the productive role of SP is in developing new tools and programs that encourage beneficiaries to invest in their assets or use them more productively. Hence, the generation of new knowledge in this area should go hand-in-hand with practice. At the same time, there is a serious agenda for systematizing existing evidence, using it for making a case suitable to the specific country context and audience. There is therefore a knowledge management agenda too.

1. **Do we know how SP affects growth?** The short answer is **Yes**. A comprehensive review of literature in this paper (Annex) reveals a rich and fast-growing field of knowledge spanning all income levels and all types of programs. We conclude that there is a strong theoretical case for productive role of SP, and much is known about exactly how social protection can contribute to economic growth. There is also an understanding of possible negative effects, and general principles of growth maximizing social protection systems will not be that different from principles for constructing an effective and efficient SP system. There is also fast growing body of empirical studies trying to estimate the precise magnitude of impacts from various forms of SP through different channels.

**Do we know enough?** The answer is **No**. There are types of programs and type of channels of impact where we know very little about and the existing knowledge about effects of program participation on net incomes of beneficiaries over the medium to long term is very thin.

2. **Would better knowledge on growth benefits help to make a case for SP, especially where a case needs to be made (LICs)?** The answer is **yes, with caveats**. We will not arrive at a simple defendable measure of growth benefits versus costs of SP valid for all contexts and capacity levels. However, it should

not discourage us from collecting the evidence at the program level and filling the gaps in terms of country/ programs coverage as well as types of effects.

**Where do we need to invest more in knowledge about growth effects of SP programs?** We need to build a stronger evidence base to help compare alternative designs against their cost. Potential growth gains can be substantial but evidence is very thin for SP instruments that address insurance market failures and help small producers to insure against risk. We should direct our attention to these programs.

**How to address the gaps? The paper proposes the program of work focused on filling the knowledge gaps by systematic stock-taking and new experimental work on productive social protection.** We should complete the review conducted in this background paper to assemble all available examples of estimating growth benefits of SP. Most importantly the generation of new knowledge will go hand-in-hand with practice in the new types of productivity enhancing social protection projects.

3. **How should the SP family evolve to use growth impacts of SP in the work on SP programs?** What we should do more? What we should do less? The practice should move to the use of systems approach to enhance the positive synergies between SP programs and minimize distortions. Jointly with our development partners we should make a case for SP as productive force and macro-economic stabilizer. We should equip our teams and partners with better evidence on growth benefits of SP as specific to a given country context as possible. We should strive for integration (where possible) of activation principles and instruments into the design of SP programs and for closer integration of social protection programs into the work of line ministries outside of social protection, especially investment, agricultural development, transportation, health, education, environment, employment and youth, and water and sanitation.

We should also enrich current practice in the existing instrument of SP by emphasizing their growth-enhancing elements. For example, for public works the economic value of assets created generally has to be treated as very important criterion; for agricultural livelihood development programs we should make progress in incorporating risk-mitigation and insurance features; for micro-credit and financial inclusion programs (focused on graduation) we should ensure consistency with economic development patterns and enhance local spillovers.

The incorporation of economic cost–benefit analysis into the selection and design of SP programs will require more operational research on specific “nuts and bolts” of social protection programs, such as duration and size of benefits, conditionalities, and provision of productive services to beneficiaries. Evaluations have to collect more evidence on the net income growth of beneficiaries of SP in the medium and long term.

To equip our (and PREM) teams to conduct the dialogue on growth-enhancing SP we should continue systematic collection and packaging of available evidence on growth impacts of individual projects and systems. We should marshal available evidence to show growth benefits of SP; provide IRR on SP investment *à la* Human Capital Rates of Return in project appraisal documents or impact evaluations (only where possible and within limits discussed in this note). We should also inform the development and revisions of macro-economic tools (SAM and simulations) for the LICs to understand and assess overall economic impacts of investment in social protection and of large scale programs (e.g., pensions, public works, and CCTs).

As a result of these efforts we hope to end the view of SP as one side within the equity/efficiency tradeoff, extend the support to SP systems among donors and international agencies, and change the design of aid and development projects to focus on promoting sustainable pro-poor growth. We seek more involvement of core economic ministries in SP reform strategies, and a consensus that spending on SP is not as residual spending priority.



## ANNEX: LITERATURE REVIEW

Many economists view social protection mainly as a **public transfer**. From the point of view of these authors increased consumption by one group (the poor) via safety nets is not by itself a compelling growth argument since the transfer takes funds from other members of the economy or increases a government budget deficit. Moreover, as these expenditures are ultimately financed by **taxes**, and these have negative effects on economic growth via the deadweight costs and economic distortions inherent in taxation.

In standard growth models (e.g., Kaldor-type factor accumulation models – see Arjona (2003) for a review) the rich have higher savings rate than the poor, thus redistribution away from the rich to the poor reduces capital accumulation and hence depresses growth. Moreover, social protection was seen as lowering incentives to work and innovate. These papers view social protection merely as an income redistribution from productive to unproductive classes (e.g., from working to retired people (Alesina and Perotti 1997)) or from successful to unsuccessful individuals. In such models there are no additional functions of social expenditure such as insurance and efficiency, only redistribution.

Other potential negative economic consequences of social protection programs include dependency, disincentives to work and lower productivity<sup>9</sup>. Critiques of social protection are also concerned with non-market failures and ineffective public intervention, caused by agency problems with the bureaucracy and political-electoral cycles (Okun 1973).

More generally, equality has been viewed by economists as being traded off against higher growth or economic efficiency, stemming, in part, from Kuznetz seminal study. Theoretically this view was challenged by Perotti (1993), who showed that in the presence of imperfect markets (closer to reality than standard assumptions) more equality spurred by SP alleviated constraints on human capital investment and hence increases factor

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<sup>9</sup> OECD (2006) provides an example of balanced view on both positive and negative effects of social protection on factors of economic growth in rich countries, focused primarily on pension insurance, see also Barr (2004) and Lindert (2007).

accumulation and growth. Some economists also challenged other presumptions on which some theoretical models were built (for example, Lindert (2004) writes, “It is well known that higher tax and transfers reduce productivity. Well known, but unsupported by statistics and history.”) A body of evidence rejects the hypothesis that social protection always creates disincentives for work in developing countries. On the contrary, evidence often shows no harmful disincentives associated with increased coverage by social protection. Barrientos and Scott (2008) discuss the dependency issue for developing countries context in great detail and show overwhelming evidence in support of little or no disincentives.

Indeed, there is now an emerging consensus that there is no automatic tradeoff between growth and equality (Birdsall at al. 1995, Benabou 1996, Ravallion 2006 and 2007, and Arjona et al. 2003). Some economists even argue that ***greater equality may lead to higher growth*** in poor countries (Perotti 1993, Devereux and Sabates-Wheeler 2007, Lopez and Serven 2009).

In this vein Rodrik (1998) showed the potential of redistributive programs to provide compensations to avoid conflicts that may be blocking growth-enhancing reforms. Barro (1990) argued that public spending even when financed by taxes can contribute to economic growth (calling them “productive”). Even though in its original contribution the “productive” public spending were associated mostly with infrastructure several authors since then have attempted to show that redistributive social protection spending can also be productive (see ILO (2005) for a review).

The role of social protection as a productive factor becomes even stronger in the globalization era, increasing interdependencies among countries that amplify exposure of individuals to competition. By increasing educational investments (greater and better human capital), and by encouraging innovation and risk taking (through insurance, broadly defined) countries could increase their competitiveness; high social protection is not harmful for strong innovation capabilities (see for example, Castells and Himanen 2002; Sabel 2010).

Corsetti and Schmidt-Hebbel (1995) present an example of how social protection, specifically pension insurance, may promote growth by encouraging aggregate savings. They concluded that certain types of pension systems promote higher saving rates and hence higher long term growth because they minimize such distortions.<sup>10</sup> Chile's pension reform of 1981 was singled out as an important factor of its exceptionally good growth performance.

However, the literature on the contribution of SP to overall growth and to its specific contribution to the growth of income for poor households is hardly confined to studies on poverty reduction stemming from aggregate savings. For example, there is a range of studies that emphasize micro-economic channels of impact from SP to growth. Similarly, local (or meso) economy effects have started to attract the attention of researchers relatively recently (Barrientos and Sabates-Wheeler 2007; Miller 2009 and FAO's from protection to production project - <http://www.fao.org/economic/PtoP/en/>). Injection of cash into such an environment can lead to a positive spiral of changes for most members of the community, not only those receiving the transfer, and hence generate multiplier effects. Since labor markets especially in developing countries are operating primarily as local markets, well known effects of labor market policies and interventions on economic performance and growth of their participants can be also included in this level.

This annex summarizes some of the key studies from the rich ongoing debate on the role of SP in fostering growth, through three broad channels: household (or micro), national economy (or macro), and also local economy (or meso) levels, which in turn can be further disentangled into a set of specific effects:

**I. Micro level links work mainly through human capital and other assets accumulation by overcoming market failures and changing behavior which induce higher productivity outcomes:**

(a) either by the effect of increasing their human capital/ skills,

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<sup>10</sup> That said, the literature on social security shows a relatively small (and negative) effect on growth from a pure inter-generational transfer of a standard pay-as-you-go system – see Auerbach and Kotlikoff (1987).

(b) or supporting the accumulation of other assets conducive to growth

or by providing households an income floor ex ante, so that they can diversify their investment choices in riskier/higher returns activities and hence attain higher income trajectories. For example, in the Handbook of Economic Growth Banerjee and Duflo (2005) discuss how insurance against risk or protection against destitution may affect decisions over risky investment or accumulation of human capital by agents facing market imperfections. The impact on growth from SP can therefore come from increased returns due to overcoming market failures.

**II. Meso (or local economy) level:**

- (a) includes creation of community assets
- (b) local economic spillovers from increased demand and positive externalities
- (c) better functioning of local (labor) markets

**III. Macro level effects (involving indirect links that enhance opportunities for all though improved overall economic performance due to the presence of SP) work through the following mechanisms:**

- (a) As automatic stabilizers and /or spending multipliers increasing growth potential of government spending
- (b) Improvement in the overall resource allocation and availability of resources, increases in capital deepening
- (c) Enable growth-enhancing reforms by compensating losers and avoiding destitution.
- (d) Reduce social tensions, crime and thus improving investment climate.
- (e) Allowing reforms which reduce economic distortions

The available evidence on these channels can be summarized as follows:

## I. Micro-channels

Overall, there seems to be growing evidence that participation in the social programs allow higher future income growth rates for its beneficiaries (IEG 2011). Note that the evidence that SP allows beneficiaries to accrue immediate income gains as a result of receiving benefits is not relevant, because that is a level effect, and the main preoccupation here is with future growth.

Most of the evidence on this subject comes from simulation analyses that seek to quantify the increased future earnings as a result of participation in a program. Such exercises provide insights into the sizeable impacts of SSNs on income growth through two main channels. One is through the increase in human capital and other productive assets. The other is through changes in behavior increasing productivity of employment.

Results based on actual changes in income are also encouraging. A few examples from this literature include:

- Beneficiaries of the *Empleo en Accion* workfare in Colombia and the Southwest UCT program in China experience sustained income gains nine months and four years after participation (Schultz 2004; Fiszbein and Schady 2009; Meng and Ryan 2004; Chen et al. 2008; Aguero et al. 2007).
- In Argentina, after accounting for the opportunity cost of their time, beneficiaries of the 'Jefes' public works program experienced a net income gain amounting to two-thirds of the wage paid (Galasso and Ravallion 2004; Galasso 2004).
- In Bangladesh, the Cash for Education program is expected to increase beneficiaries' lifetime earnings up to 25% (Barrientos and Dejong 2004).
- Conditional Cash Transfer (CCT) programs yield large gains in the form of future earnings both in Mexico and Nicaragua (Rawlings and Rubio 2004).

Now we look in more detail into specific channels that produce these outcomes and at the countervailing forces:

***I (a) SP programs allow investment of credit constrained poor HH in human capital, increasing their employability as adults and boosting future income growth***

Social protection, and more narrowly one part of it – social safety nets (SSNs) – have a documented role in helping the poor to protect and build their main productive asset, labor. Impacts on income growth are occurring through two main channels. One is through the increase in school attainment. The other is through improved nutrition and health.

More theoretical discussion of links between health and growth can be found in a paper by David Well (2007) and a recent NBER paper by Aghion et al. (2010). The authors discuss a wide range of direct and indirect impacts and agree that measuring the magnitudes is a real challenge. Most of the careful work leads to assessment of the aggregate economic return on improved health as rather small, although the rate of return on investments in health and nutrition for low income households, presumably those with greater health risks, is quite high (Behrman et al. 2004).

Krueger and Lindahl (2001) performed a cross-country analysis when looking at the effect of education on growth. Bils and Klenow document the causal link from education to aggregate growth (2000) while Hanushek and coauthors take this one step further by suggesting that learning rather than attendance is the key channel of impact. While many of the current studies that investigate how SP increases the demand for schooling by substituting for missing credit markets or by changing the opportunity cost of education only document the increase utilization of services (health or education) given the more general literature on such investments it is quite possible that the time frame of the evaluations is too short to measure changes in the stock of human capital (King and Behrman 2009). The empirical evidence on the human capital effects of safety nets mediated through education is summarized in Grosh et al. (2008) and Fiszbein and Schady (2009) and is large in scope and depth. It includes a showcase of Mexico and growing set of examples from other areas:

- In **Mexico** CCT (Progresa/Oportunidades): decreased stunting (among the poorest children in rural areas, especially younger children); reduced infant mortality (a municipality with full coverage of Progresa/Oportunidades has 11% lower infant mortality rate than it would have had without the program); fought anemia prevalence (children who received Progresa/Oportunidades transfers had 10 percentage point lower anemia (54.9%, compared to 44.3%); reduced incidence of illness (after 2 years of program exposure, children in Progresa/Oportunidades treatment area were 40% less likely to be reported to have been ill by parents than those in control area) – (Skoufias 2001; de Janvry and Sadoulet 2006; Behrman and Hoddinott 2005).
- IEG (2011) has made comparisons across evaluations and impact assessment of six CCTs implemented in countries at different income levels: **Nicaragua, Honduras, El Salvador** (lower-middle income), **Colombia** (middle income), and **Mexico and Turkey** (upper-middle income). All but one of the programs increase enrollment by amounts ranging from 2 to 13 percentage points in primary school; three programs increase enrollment in secondary school with impacts in the 6-11 percentage points range.
- IEG (2011) compared in a similar way (meta study) six similar school feeding interventions implemented in five countries (**Burkina Faso, Uganda, Kenya, Bangladesh, and India**) and found that they deliver similar positive impacts on school attendance, ranging from 6 to 20 percentage points increase.
- Using the same methodology, IEG (2011) analyzed evidence from similar CCTs in **Nicaragua, El Salvador, and Colombia** with comparable data shows that the programs reduce morbidity (measured as the prevalence of diarrhea during the reference period of the survey) by a similar amount, from 4 to 9 percentage points.
- In the case of the **Uganda** school feeding has an indirect but significant additional nutritional benefit on younger siblings of schoolchildren (Alderman et al 2008).

- Several design features (e.g., targeting women) can greatly enhance the human capital investment effects of such programs (See Gitter and Barham (2008) for an example from **Nicaragua**).

***I (b) SP programs allow investment of credit constrained poor HH in their livelihoods/physical assets/inputs.***

This channel includes two very different forms of impacts: direct and indirect. We first describe direct impacts from programs that traditionally are labeled as “productive” safety nets or “livelihood” programs.

***Direct effects from programs aimed at creating productive assets/ supplying inputs.***

These programs take two forms: *transfer of productive assets* or conditionality-linked cash transfer facilitating asset creation, or *micro-credit interventions* which may or may not involve grant component. This channel is especially important for small farmers who often are cash constrained (ODI 2007). Mexico’s PROCAMPO program is an example of such a means of assisting farmers. While this was designed as a transfer to compensate farmers when subsidies were removed as part of trade reforms, the program also relaxed credit constraints and led to increased production (Sadoulet et al. 2001). There is also growing evidence that asset transfers can be combined with participation in financial inclusion programs which are capable of spurring the additional direct effect (e.g., by providing money through savings accounts rather than cash handouts). Similarly, social transfers can be combined with micro-credit interventions (CGAP 2001) as shown by the experience from BRAC (see below). For example, Chars Livelihoods Programme (CLP) in Bangladesh provides the one-time transfer of investment capital, accompanied by a package of other social and market development inputs to the 50,000 poorest households living on island chars (areas of new land formed through soil erosion and deposition). To achieve significant and sustainable incomes, around £100 of investment capital, with further training and support worth £100 per household, are deemed necessary. From the different choices offered to households in early 2006, the ‘fixed package’ of 1 heifer, 4 goats and 10 chickens per household proved least successful, with many of the animals dying or being sold. A flexible

asset package proved more successful, as did one in which new assets were accompanied by livestock services (de-worming, vaccinations) plus a stipend of approximately £2.20 per month over 18 months, which removed the need to sell assets in order to meet regular needs (ODI).

Another form of well-established “productive social protection” are **vouchers for farm inputs** which entitle farmers to buy modern inputs (usually fertilizer and improved seeds) from participating input retailers at a subsidized price. Following the various supporters and detractors of Malawi’s large scale agricultural input subsidy program and reforms to that program, targeted input subsidies are now also accepted by the donor community as a way to boost smallholder productivity, provided the programs are “market-smart” (World Bank 2007; Dorward and Chirwa 2011). Market-smart input subsidies are part of a broader productivity enhancement program, have clear exit strategies, and most importantly, they are carefully targeted at overcoming market failures. Looking at the Tanzania input voucher program they reflect on the program’s simultaneous pursuit of multiple objectives (raising aggregate output versus raising poor farmers’ income), which each yields different targeting rules (targeting farmers with highest marginal productivity versus targeting poor farmers). They show that it leads to a targeting practice focused on the lowest common denominator that tries to serve all in theory, but serves none well in practice. They note that it is possible to overcome this dichotomy by targeting farmers with higher marginal productivity (most will happen to be small poor farmers) through the development of better proxies to target households with high marginal productivity (where the practice is in its infancy).

- For every dollar spent on the PROCAMPO program in **Mexico** – a large cash transfer program targeted to compensate farmers from the impact of NAFTA - household income increased by US \$1.60 to US \$2.40 of income (Sadoulet et al. 2001). This likely reflects the removal of credit constraints – 70% of the PROCAMPO respondents purchased agricultural inputs with these transfers.
- In **Bangladesh** the BRAC, one of the largest NGOs has been targeting the ultra poor since 2002. The participants show greater rates of asset accumulation than non-

- participants in all asset domains, and are improving their nutritional status and food security (Hulme and Moore 2008, Hashimi)).
- Several micro-credit/asset building CCTs schemes have been recently sponsored by the Ford Foundation in LICs (CGAP 2009)
  - Targeted input subsidies for small farmers are traditionally viewed as ‘productive safety net’ par excellence (Farrington et al. 2004). However, they are increasingly coming under scrutiny, in part due to a weak targeting mechanism which is a distinct issue from the productive potential of a well-run program (Brooks 2010; Lei Pan and Christiaensen 2011).

***Investment/assets/saving increases from social transfers and programs not specifically designed to target asset creation (indirectly)***

By providing income streams SP participation works towards building household assets. This evidence challenges the assumption that the poor do not save. Beneficiaries of transfers invest in assets (such as livestock and trees), particular business activities (such as micro-enterprises and self-employment), or critical agricultural inputs (such as seeds, pesticides, fertilizers, and equipment). In addition to direct investment beneficiaries make out of transfers, the regularity of transfers may facilitate access to credit markets (see example from Brazil below). Here the evidence is growing especially rapidly, not the least in Africa where some countries instituted universal pensions/child grants that are found to have positive spillovers on their beneficiaries’ ability to earn independently. The evidence base is, nevertheless, seldom from controlled studies, although this is also changing:

- All of the four studies reviewed by IEG (2011) that investigated the impact of SSNs on the saving and borrowing capacity of households demonstrated a positive effect. This includes a CCT in **Paraguay**, two welfare programs in **Ethiopia and Colombia**, and a UCT in **China**.
- In **Mexico**’s *Oportunidades* program recipients after eight months in the program (three payment cycles), invested 14% *Oportunidades* transfers, notably in farm animals (first small production animals then lumpier draft animals) and land for

agricultural production as well as micro-enterprises. The aggregate effect of the investments yielded a 1.9% increase in consumption for each peso of transfers received. These estimates indicate an estimated rate of return on investment of 15.3% in term of income and 13.2% in terms of consumption allowing them to raise their consumption by about a third after five and half years in the program – with an estimated rate of return of 17% (Gertler et al. 2007).

- The investigation of how beneficiaries of social grants/pensions in **South Africa** show many overwhelming roles of productive investments: seed money for informal economic activity; inputs for agriculture, for enlarging assets, improving homes, supporting education, or towards migration in search of work; it has been established a long time ago that beneficiaries improve access to credit, thanks to the regularity of pension payments (Ardington and Lund 1995; RSA 2001; CPRC 2009; Ardington et al. 2009).
- There is evidence that the benefits of RPS, a CCT in **Nicaragua**, increase investments in agricultural equipment (Maluccio 2007).
- Recipients of **Mozambique**'s food subsidy program use the money as working capital for petty trading, for rearing chickens and selling the eggs, and for making and repairing clothes (Devereux et al. 2005).
- Even those whom we might think of as dependent, such as pensioners in **Lesotho**, have been able to use cash transfers to make small investments (Devereux et al. 2005).
- As much as one third of the money transferred to the beneficiaries of **Zambia**'s Kalomo Pilot Scheme – destitute households, most affected by HIV/AIDS, headed by older people – was invested in the purchase of small livestock (e.g., poultry), in farming, or for informal enterprise (working capital for making baskets) (Devereux et al. 2005).

- A food-for-work program in northern **Kenya** during the lean season allowed households to purchase additional agricultural inputs and increase net returns of their farms by 52% (Bezuneh et al. 1988).
- Malawi social cash transfer is found to increase dramatically the ownership of agricultural assets, especially poultry (by 50%) in a robust evaluation using counterfactual (Covarrubias et al. 2011)
- **Bolivia**'s Bonosol (*Bono Solidario*) pension recipients in rural areas the invest their transfers in small holder agriculture and as a result their food consumption went up by twice the amount of the transfer received (Martinez 2004).
- In **Brazil**, a social pension named *Prévidencia Rural* was introduced to cover informal workers and their households. The regularity of the pension benefit enabled pension beneficiaries to access loans from banks by showing the magnetic card which gives access to their pensions. A study of the impact of the pension on the households of recipients observed a high incidence of investment in productive capital (in Brazil-MDS 2007)

***I (c) Social protection by providing some hedging favors risk taking and higher returns activities***

By providing households an income floor ex ante social protection encourages diversification of their investment choices into riskier/higher returns activities leading to higher income trajectories. This pathway is by nature **indirect**, any reliable social transfer, regardless of its “productivity” can play a role of such insurance.

The academic studies on this pathway have been nicely summarized by Banerjee (2000) and by Chetty and Looney (2006): social insurance could replace more costly methods of consumption smoothing, mitigating the ex ante effects of risk. Chetty and Looney (2006) show that the welfare gains from increasing insurance cannot be directly inferred from the size of consumption drops. Another recent theoretical paper on insurance and investment is by Angelucci et al. (2009). They show that social protection overcomes credit market failure which forces households to either pursue negative coping strategies – such as pulling

children out of schools or selling their assets -- or not to enter into high risk/high return activities or even accumulate assets. This carries over to non-eligible households through risk sharing arrangements.

Devarajan and Jack 2007 develop a model to compare publicly provided insurance for private individuals with the provision of risk –reduction public goods. They show welfare enhancing effect of public insurance that could be an additional instrument to enhance social welfare compared to social assistance targeted to the poor. They show that a simple public insurance scheme that pays a fixed benefit to all households that suffer a negative shock is an effective redistributional instrument of public policy, achieving poverty reduction objectives. This is true even when a well functioning private insurance market exists, and so the role of public insurance is not to correct a market failure.

Elbers et al. (2007) demonstrate precisely how a more predictable income stream could move SP beneficiaries to higher income trajectory. They use panel data from Zimbabwe to show that households accumulate less capital in the face of greater risks thereby lowering both the level of per capita income while increasing income volatility. They argue that risk mitigation schemes such as insurance programs and/or safety nets will raise growth rates and reduce the volatility of growth by a significant amount: the average (across households) actual long-run capital stock is estimated to be 46% lower than in the absence of risk. This has very large effects in terms of depressing income growth. They argue that the potential benefits of policy interventions to reduce exposure to risk or promote insurance or credit may therefore be much greater than previously envisaged.<sup>11</sup>

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<sup>11</sup> Some evidence on the cost of income smoothing was provided by Morduch (2006). In Shandong Province in northern China, while on average incomes were growing at 8% a quarter of the population in any given year was suffering losses of about 20%. Health and weather shocks are the most likely sources of risk to a household's welfare. Innovations in weather-based indexes and health insurance have provided new tools that overcome many of the problems of traditional insurance schemes, but empirical analyses show that there is still a large difference between the ability of the poorest households to pay for these services and the cost at which they can be provided. It is hard to imagine that this gap between demand and supply can be bridged without public intervention or collaboration with civil society organizations

Barrett, Carter and Ikegami (2008), Carter and Barrett (2006) and Binswanger and Rosenzweig (1993) discuss the theory of poverty traps and social protection. They argue that much of the value of the productive safety net comes from mitigating the *ex ante* effects of risk and crowding in additional investment. The analysis also explores the implications of different mechanisms of targeting social protection transfers/insurance. In the presence of poverty traps, modestly regressive targeting based on critical asset thresholds may have better long-run poverty reduction effects than traditional needs-based targeting. Devarajan and Jack (2007) argue that there is self-targeting element in the provision of public insurance that compensate the victims of bad outcomes.

There is an impressive literature on the ***actual*** effects of participation in social protection programs on longer-term growth due to suppression of negative coping strategies (such as school drop outs), ***but effects are seldom precisely estimated***. The empirical evidence on how SPs are reducing the incidence of negative coping strategies, such as school drop outs and have positive effects on child health and nutrition, is summarized in Schady (2006). The effects are also measurable over a larger time span, as they aim at breaking the intergenerational poverty (see Ravallion and Jalan 2001). The short-term effects of safety nets are evident during the episodes of crisis when unprotected households experience hunger/malnutrition; decreased use of health care or worse health outcomes; and loss of schooling.

- In **Indonesia**'s financial crisis, a scholarship program and waivers for health care fees helped families keep their children in school and get health care (Saadah et al. 2001; Cameron 2002; Giles and Satriawan 2010). The Jaring Pengamanan Sosial (JPS) scholarship program was launched by the **Indonesian** government in response to the crisis of 1997-98 to prevent the decline in student enrollment and it largely lessened this decline. The evaluation also found that the program allowed households to stabilize their consumption, protect their investments in education, and reduce child labor; but the long term growth effect is hard to estimate (IEG 2011).

- Evaluation of another program - **Ethiopia**'s Productive Safety Nets program demonstrated that 3 in 5 beneficiaries avoided having to sell assets to buy food in times of drought (Devereux et al. 2005). A smaller program but with a similar design has not resulted in comparable benefits in **Malawi** (Chirwa 2004).
- **Mexico**'s *Oportunidades* mitigates the impact of shocks on enrollment therefore preserving the stock of human capital in the face of negative shocks and allowing higher income growth in the future. Moreover, the program allows even non-beneficiary households to borrow more when hit by a negative idiosyncratic shock so that they could reduce their precautionary savings and increase investment. The precise magnitude of impact on growth is not easy to estimate (Gertler, Martinez and Rubio-Codina 2007). As with many transfer programs, *Progresa* was not designed to address shocks even though the examples discussed here illustrate that it can serve this function. For a general discussion of the features of safety nets that are suited to addressing shocks (see Alderman and Haque 2006).
- Food-for-work program in **Ethiopia** helped mitigate the negative effects of crop damage on child growth (Dercon and Krishnan 2004; Yamano et al. 2005).
- Devereux (2002), based on evidence from the Employment Guarantee Scheme (EGS) in Maharashtra, **India** shows that the program has encouraged farmers to take greater risks by planting higher-yielding crop varieties. The duration of participation in the program reduces the variance of household income among beneficiaries.
- Households enrolled in the AC CCT pilot in **Nicaragua** were found to be six percentage points less likely to increase the involvement of their children in income-generating activities when confronted by shocks (IEG 2011).
- CCT in **Nicaragua** (RPS) and CCT in **Honduras** (PRAF II) appear to have protected the consumption of coffee-growing households when they were affected by the considerable fall in international coffee prices. How it affected long-run income growth trajectory of participating households is not known (IEG 2011).

- In **Malawi** the Social cash transfer pilot helped participating households to avoid detrimental coping strategies undermining their social and human capital: begging for food or money dropped by 14% while pulling children out of school in order to work for food or money fell by 36% (Covarrubias et al. 2011).
- Recipients of the *Bolsa Familia* CCT (formerly *Bolsa Escola*) in **Brazil** used the cash transfer to diversify their income portfolio, potentially enhancing the ability of the poor to protect against adverse economic shocks, but with an estimate of growth not easy to come by (IEG 2011).
- Hashemi (2001) finds the Income Generation for Vulnerable Groups Development (IGVGD) program in **Bangladesh** combines food transfers with micro-credit shows that over 90% of participants started borrowing from micro-credit organizations after the two year IGVGD cycle was complete, thus becoming creditworthy.
- The income of program participants of *Trabajar* II and *Jefes y Jefas* in **Argentina** fell less compared to that of the control and their income and employment recovered more quickly after the crisis that hit the country in the early 2000s (Galasso and Ravallion 2003).
- In a few cases in the literature social protection influences the type of work and economic sector in which working-age adults choose to engage. Some evaluations found that programs produce positive changes in employment quality and returns: The *Proempleo* wage subsidy experiment in **Argentina** increased wage employment significantly and reduced temporary employment (Galasso et al. 2001).
- A food aid program, *Programa de Apoyo Alimentario* (PAL), and *Oportunidades* (both in **Mexico**) resulted in a reallocation of labor from agricultural to non-agricultural activities with higher returns (Skoufias et al. 2008; Behrman et al. 2010).
- Another study assessed the impact of **Brazil**'s *Bolsa Familia* program on the probability of starting a new business. The key finding is that the program does stimulate entrepreneurship in urban areas though these enterprises are typically a

household's secondary occupation – however there is no impact in rural areas (Lichand 2010).

***Social protection does not usually create dependency and /or reduced work effort***

Against a backdrop of positive effects on employment activity levels, productivity and assets, there is a concern that participation in social protection programs<sup>12</sup> may induce reduced effort/dependency that may undermine these favorable effects, at least in theory. Most empirical studies in the developing countries do not demonstrate such effects (DFID 2006), but it is nevertheless important to understand instances when such effects do arise to minimize them through design of programs. We first list studies which provide evidence that such effects are not empirically observed in the developing world, and then a few studies which show that these risks are real with certain design flaws.

- While leisure is a normal good and thus theory and evidence of labor supply would lead one to expect that nonwage income would lead to reduced labor supply there is actually little evidence that the size transfers in programs targeted to low income households has a measureable impact. For example, a review of over 130 studies on the impact of safety nets produced by IEG of the World Bank (IEG 2011) most of the programs that are not expected to directly affect labor supply appear to have no impact. For example, none of the four CCTs evaluated from this point of view discourage beneficiaries from working (see for example Parker and Skoufias 2000; Ardington et al. 2009; Skoufias and McClafferty 2001).
- **Turkey's CCT program** requires participating mothers to go into town, to government offices and banks, a first for many of them, helping them to get in contacts with the job market (Grosh et al. 2008).
- Research in **Mexico and South Africa** suggests that transfers make work **more** feasible, as recipients can afford bus fares and presentable clothes for work or fund migration from rural to urban areas (Marcus 2007; Ardington et al. 2009).

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<sup>12</sup> There is also a concern that labor market policies will restrict entry and exit and a different concern that unemployment insurance leads to increased unemployment.

- Evidence that SP program participants have sustained income growth *after* leaving the program is used against a dependency argument. Beneficiaries of the welfare program *Empleo en Accion* in **Colombia** and the Southwest UCT program in **China** experience sustained income gains 9 months and 4 years after participation, respectively. Participants of **Ethiopia** (Employment Generating Scheme) showed increases in consumption 9 to 18 months after they exited the programs; parallel trends in consumption growth are found for CCT beneficiaries in **Colombia and Mexico** 2 years and 5 and a half years, respectively, after they joined the programs (Schultz 2004; Meng and Ryan 2004; Aguero et al; Chen et al. 2008; Gilligan and Hoddinott, 2008; Gertler et al. 2006).
- Very careful analysis showing that participation in cash transfers *did not* lead to a reduction in work effort in schemes has been conducted in **Mexico and Brazil** (Skoufias and Di Maro 2007 for Mexico and Foguel and de Barros 2010 for Brazil)
- Ravallion and Wodon (2000) also found very small changes in labor in a FFE program in **Bangladesh**
- One contrasting piece of evidence, however, comes from **Sri Lanka** where a study has shown earnings in Sri Lanka going down for food subsidy recipients by almost 30% of the value of the food subsidy due to a lower level of work effort from a high base (Sahn and Alderman 1996). A similar impact was noted for **Nicaragua's** CCT RPS which reduced the hours worked by adult men and women by 3 and 6 hours per week, respectively (Maluccio and Flores 2005).

## II. COMMUNITY AND LOCAL MARKETS: IMPACTS OF SP ON ECONOMIC GROWTH

A very important channel of impact on long term growth is investment in community infrastructure that generates returns to all households with productive assets (road rehabilitation, preventing environmental degradation etc.). Less directly, the dependable spending power created by social transfers (pensions or CCTs or even local procurement of school feeding) supports the development of local markets and revitalizes local economic activity. SP especially in poor countries is often targeted toward specific geographic areas

with high concentrations of poor and vulnerable people. There is evidence of geographic externalities in local economic development, especially in rural areas, owing to spillovers on the level and composition of local economic activities and changes in the returns to human and physical endowments (Ravallion and Chen 2005). Finally if the poor suffer from asymmetric power relationship with the lenders or buyers of their products then getting access to social protection may help them to somewhat redress the balance. These channels are discussed further below.

***II (a) SP creates local productive assets that are complementary to household level investment and allow higher productivity (e.g. rural roads improving connectivity to markets).***

The link between infrastructure investment and growth is well established (Calderón and Serven 2003). First there is the direct effect of the employment created by those working to build the infrastructure. Second there is the growth effect resulting from connecting the poor to core economic activities, which results in second round employment and output impacts (Estashe and Fay 1995; Estache 2003). However, the empirical evidence on this channel is growing, including through already mentioned FAO project (Filipski and Taylor 2012).

*Public works programs* are the safety net intervention with the clearest link to infrastructure development. The best known examples of targeting local economic growth in the design of social protection include several public works schemes. ILO has recently produced a body of operational guidance on how to maximize these effects (EIIP, Employment-Intensive Investment Program)- ILO2011b, while Subbarao, del Ninno and Andrews (2010) look at the best practice examples.

- A well-known example is the **Productive Safety Nets Program** (PSNP), a component of the Government's Food Security Program (FSP), a series of complementary interventions aiming to graduate rural citizens to sustainable food security. While the PSNP aims to reduce household vulnerability and build productive community assets through public works, the complementary Household Asset Building Program

(HABP) aims to diversify income sources and increase productive assets, and finally other elements of the FSP invest in the enabling environment. Rural households are targeted into the program and once enrolled they may participate in the PSNP for multiple years until their livelihoods reach the graduation threshold defined by the program - they are able to meet their food needs for all 12 months and withstand modest shocks (food sufficient). In 2009, PSNP public works were operational in almost a third of Ethiopian *woredas*, generating an estimated 190 million workdays of labor. The PSNP covers families with 8.3 million people (out of 79 mln. population). The PSNP achieved robust results in HH asset protection: 62% of participants avoided selling assets, and 36% avoided using savings to buy food. Moreover, 23% of participants acquired new household assets. Finally, 46% used healthcare more 39% sent more children to school and 50% kept them in school longer. Moreover, each year, the PSNP initiates roughly 34,000 public works projects that focus on soil and water conservation, social infrastructure and roads making major contributions to local level service delivery and improving quality of local level investment planning.

- **Indian National Rural Employment Guarantee Act (NREGA)** With a 2006–07 budget of some £1bn, equivalent to 0.3% of GDP, allocated under the umbrella of the Indian National Rural Employment Guarantee Act (NREGA), this is probably the largest rights-based social protection initiative in the world. NREGA provides for up to 100 days of work to each household falling below the poverty line. NREGA has the potential to bridge social protection and growth, by creating or rehabilitating growth-related assets useful to the poor. NREGA has contributed to setting up water harvesting structures, minor irrigation tanks, community wells, land development, flood control, plantation, etc.
- Inspired by the evident success in income maintenance by the Maharashtra Employment Guarantee Scheme (see Subbarao et al. 2010) it is too soon to assess whether the NREGA will be able to achieve a similar level of consumption smoothing

or whether the employment generation will have growth linkages. One paper estimates the potential impact of NREGA schemes on village-level incomes, output and employment using a Social Accounting Matrix (SAM) created using data from each household in the village. The first channel that is assessed is the direct multiplier impact due to increased wages from program participation. The second channel estimated the farm productivity improvements arising from one of the NREGA schemes to de-silt six dams – the additional output due to this was 2.2%. The positive spillovers were found to particularly benefit marginal farmers (Hirway et al. 2008). However, early evidence suggests only limited awareness among the poor of their 'right to work' (especially in more remote tribal areas), and a focus on a standardized set of assets, with little consideration for local relevance. Two further difficulties from the growth perspective are that NREGA does not provide skills enhancement and does not, therefore, strengthen human capital. In addition, by taking (state sponsored) work to the people, it may discourage them from moving to more economically dynamic areas.

- Cash for work program in **Ethiopia** (North and South Gonder Zone) has contributed to substantial asset creation in the communities (Ejigayehu Tefera et al.).

### ***II (b) SP programs create local or economy-wide economic spillovers***

Typically positive changes among non-beneficiaries in the same communities result from demonstration and peer effects. Beneficiaries can also use cash transfers for improvements in their production techniques that enable an improved allocation of local resources with impact on non-beneficiaries (e.g. increased local demand for labor). Behavioral changes also affect social interactions and can overcome some coordination and market failures. In a village environment where households take production decisions jointly lack of savings and absence of credit market imposes heavy constraint on the productive choices (see Lei Pan and Christiaensen 2011); overcoming these constraints may increase participation in social networks (mutual insurance).

The analysis of economic impacts at the local economy level generally relies on simulations using social accounting matrices or market equilibrium models. Existing methods include specific analyses of interactions inside communities (Angelucci and di Giorg 2009); social accounting matrices and general equilibrium models at the regional and village levels (Pfeiffer et al. 2009; Filipski and Taylor 2012; Taylor 2012 – papers prepared for FAO 2011) and their reduced versions (Davies and Davey 2007). These show generally positive effects on productivity of farming households from increased non-farm incomes in the concerned communities (represented by SP transfers in this case).

Some forms of input/asset creation programs can create positive/ or negative externalities to the non-participants in the form of lower food prices. If implemented at a sufficiently large scale, SP support to farming assets or input subsidies can substantially increase production. Where staples are non-tradable, this can reduce staple crop prices, but also encourage off-farm activities. Such linkage effects have been documented to be still important in Africa (Henderson et al. 2009).

A relatively high volume of transfers could also create either negative or positive externalities for these communities in the form of changes in local prices or wages due to fluctuations in liquidity or labor supply. Increased demand for food when cash payments are delivered or when food for school meals is locally procured can raise prices, depending on market integration and local supply response. However, even were this to occur, the impact on poverty or growth depends on whether the target population are net producers or net consumers. But markets could be also (oligo-) monopolistic, and transfers may generate some inflationary pressures, hurting both beneficiaries and non-beneficiaries (negative spillovers).

These effects are difficult to pin down empirically, but the literature is rather rich<sup>13</sup>. One line of research being applied in this area is to explore micro-macro linkages, other looks at the

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<sup>13</sup> For example, there is a large literature on food aid, well reviewed by Barrett, 2005.

interactions among beneficiary and non-beneficiary households, and third addresses the local market failures and effects of SP on these.

- For example, Angelucci and di Giorgi (2009) show that ineligible households in localities where there are **Mexico's Progresa/Oportunidades** beneficiaries stand to benefit from the program in the form of increased gifts and loans from beneficiary households.
- In a similar study in **Malawi** Covarrubias et al. (2011) found significant reduction of transfers to households participating in the social transfer program from their non-participating peers as part of the informal mutual support mechanisms. Such networks are composed of peers who are also often poor, hence formal cash transfers reduce strain on the informal networks, and improved welfare of non-participating households.
- The most complete set of empirical results on **transfers from beneficiaries to non-beneficiaries of SP programs** is accumulated for rural non contributory pensions (for **South Africa**, Moller and Ferreira 2003).
- For **South Africa** Extended public works programs have boosted local economies: a survey indicated that 67% of workers purchased most of their food from local shops, indicating that resources were flowing into the local economy. However, they find no evidence that the construction of the roads had brought direct economic benefits (McCord and van Seventer 2004). The larger issue of whether these linkages are greater or lesser than a similar spending on less labor-intensive activities or in different communities is not tackled in this study; indeed it is seldom addressed in the literature. However, we emphasize that the question of the growth and income enhancing role of SP is about the degree to which SP includes growth as well as equity, not whether it is equivalent to or better than other investments in the single metric of growth.
- The most densely studied program from the point of view of local multipliers is **Brasilia's Bolsa Familia**. Most of the studies are published only in Portuguese

(Landim 2009), but their summary showing sizeable effects on municipal economic activity and employment is available in Brazil-MDS (2007) (full set of evaluations is available at <http://www.ipc-undp.org/mds.do>).

- Mexico's *PROGRESA/ Oportunidades* evaluations have demonstrated local growth-enhancing effects, while impact on prices from increased liquidity was negligible (Angelucci and De Giorgi 2006; Barrientos and Sabates-Wheeler 2009). The most surprising observation of these evaluations was the finding that non-beneficiary households in localities with beneficiaries have accumulated assets faster than similar households elsewhere. Barrientos and Sabates-Wheeler (2009) hypothesize that this may be driven by positive strategic interactions between agents.
- One cash transfer program in **Ethiopia** increased access to social services and led to higher circulation of cash, resulting in increased competition and local trade (Adams and Kebede 2005).
- However, Sabates-Wheeler and Devereux (2010) document inflationary effects in some regions of **Ethiopia**, where program implementation issues resulted in unpredictable lump-sum transfers and traders were slow to adapt to increased demand, or took advantage of their local monopoly power. These price hikes negatively affect both beneficiary and non-beneficiary households.
- Barrett (2001) thoroughly reviews the effects of food aid on local prices throughout the world. The empirical results have been mixed, with upward and downward pressures noted in different areas. Much of this research was focused on food for work program.
- A social accounting matrix analysis of the Dowa Emergency Cash Transfer (DECT) program in **Malawi** found multiplier impacts from the payments broadening benefits to the entire community (Davies and Davey 2007). They show that the total multiplier effects of the DECT during the 2006/7 lean season reached between 2.02 and 2.79 according to different assumptions about the openness of the region.

These effects work through increased sales of small and large traders and more purchases of health and education services.

- Using the methodology proposed in Taylor (2012) the FAO (2011) team estimated full village model based on SAM approach for the **Lesotho Child Grant** program. Preliminary results show a range of plausible multipliers, all well above 1: ranging from 1.17 to 1.23 (and to 2.43 in a scaled up version of the model including full linkages with non-beneficiaries). See Davies (2012) for a presentation within FAO 2011.
- Some new evidence is being built in the context of shifting procurement in food assistance programs to the locally produced food. Several pilot projects document a number of positive changes to local rural economies that occur as a result (World Bank- WFP 2009 discusses school feeding, Omamo et al. list some other examples based on WFP projects; FAO 2011).
- The school feeding program in **Togo** that is using innovative mechanisms to engage local food producers has documented large positive spillovers in the communities under the program.

***II (c) SP programs improve functioning of labor markets, or overcome constraints imposed by the absence of markets, or asymmetric market power relationships.***

- The most well known area where the employment (and growth) benefits of social protection interventions are thoroughly assessed is the design and evaluation of active labor market programs.
- The global evidence on labor market programs is very strong: they do increase employment of participants, and hence result in some growth benefits. (Auer et al. 2008; Betcherman et al 2004).
- Cash for work transfers in **Ethiopia** (Meket Livelihoods Development Project) have enabled poor households to renegotiate contractual sharecropping and livestock arrangements with richer households (Adams and Kebede 2005).

- Cash transfers to landless laborers in **India** have also been found to transform the conditions of otherwise exploitative clientelistic relationships, by decreasing the beneficiaries' need for, and thereby bargaining power with respect to, such arrangements (Greenslade and Johnstone 2004).
- In **Zambia**, Kalomo beneficiaries were able to avoid selling their maize cheaply after harvest and buying it back at high cost later, instead using their transfer income to meet essential expenses; 80% of the social transfers are spent on locally purchased goods, stimulating enterprises in rural areas (Devereux et al. 2005).

### **iii. Macro Level/ Political Impacts Of Social Protection On Growth**

Macro level literature/evidence is composed of two large strands. One consists of studies focused typically on **short term/medium-term multiplier effects from spending on social protection**. They demonstrate such effects using time series of Social Accounting Matrices for a specific time period and specific country. Even though such growth effects come from boosting overall demand in the context of unused capacity (and therefore may not be leading to higher growth path), there are arguments maintaining that preventing volatility of output helps economies to reach better utilization of resources. Second strand is more focused on the **long term efficiency –enhancement stemming from the role of social protection in addressing economy-wide market failures**. In this strand most cross-country studies using regressions and long term time series can be found.

#### ***III (a) Social protection transfers work as short term automatic stabilizers and have high medium term multiplier effects.***

Transfers can play the role of automatic stabilizers of demand, helping the economy to improve its long term growth path. The role of social security systems as an automatic stabilizer during crises has been widely acknowledged during the recent global financial and economic recession (ILO 2011; EU 2011). It has provided compelling evidence that countries with effective social security systems can react quicker and more effectively to a crisis. In principle, putting more cash into the hands of poor people should be good for growth.

Specific SP spending multipliers may be higher than other Government spending. This could explain why in an economy with aggregate demand constraint increased consumption by one group (the poor) via safety nets can be compelling short- to medium term growth argument even when the transfer takes funds from other members of the economy or increases a deficit. There is ample evidence that the poor consume differently than the non-poor, particularly with a higher share of non-tradeables. This increases the multiplier and is a variation of the linkages argument that John Mellor (and, later, Peter Hazell) used in regards to investments in rural economies. In addition to short run stabilizing impacts (increased output) there are also effects in the context of long run growth regarding the benefits of more stable patterns of capacity utilization. Levy (2007) discusses a possibility of misallocation of investment due to the differences in social protection coverage across formal and informal sectors, but his arguments are not regarded as fully compelling (Brookings Institution 2008).

The macro-economic effects of the social transfers are difficult to measure.

- In some countries with widespread poverty CGE modeling based social accounting matrices show noticeable direct growth effects (e.g. in **Cambodia**, CPRC 2009).
- A series of empirical studies **on South Africa** clearly shows that social assistance expenditure has promoted investment, economic growth and job creation, and that these expenditures have improved the trade balance. Low-income households spend relatively high proportions of their income on domestic goods and services; hence an increase in their income tends to favor domestic industries (Williams 2007).
- Another study assessed the impact on GDP of the construction sector in **South Africa** comparing labor-based public works methods versus 'mechanized methods'. Using an input-output framework the paper estimated the multiplier impact of the labor income generated by public works construction projects and concludes that given the extent that the mechanized methods rely on imported materials, the labor

based methods contribute more to growth (Standish 2003; McCord and van Seventer 2004).

- The 2009 multi-billion dollar **US** stimulus package led to a renewed interest in the growth impact of spending. A recent study compared the growth impact of a dollar spent on food stamp programs, infrastructure service, unemployment insurance benefits and general aid to state governments in the United States. While investments in infrastructure and the extension of unemployment benefits are estimated to have the same multiplier (1.6), a temporary expansion of the food stamp program is estimated to have the largest impact on growth with a multiplier of 1.7 (Zandi 2009).

***III (b) Improve overall resource allocation and availability of resources to sustain higher growth and innovation in the long run.***

Among those effects a channel that increases national savings are most commonly cited channel of impact for pensions. Pension and unemployment insurance provided through SP are also believed to reduce equilibrium labor cost; this is a result of the risk-pooling under social protection, which allows for achieving pre-defined lifetime income levels at a lower cost than where workers would have to strive individually for lifetime income security. In short, risk-pooling reduces the equilibrium wage, frees resources for investment and, thus, contributes to productive employment. There are also other channels.

ILO (2005) for example notes that formal social protection systems provide an enormous source of information to business on core parameters of competition, such as national and regional employment and wage structures. Thus, social protection helps to improve coordination and to avoid growth-hampering decisions of firms. Also, through the participation of employers, workers and governments in social protection administration, core economic actors dispose of an invaluable communication network fostering growth. These effects are difficult to pin down in a full theoretical model, but there is a large empirical literature using cross-country regression frameworks, some of it summarized below:

- The literature on empirical link between the size of transfers and growth is rather large although with mixed results. Some studies (for example, Persson and Tabellini 1994) find that various social transfers have a significant negative effect on growth in samples of OECD countries, whereas other studies find a positive effect (Korpi 1985).
- Recently Campos and Coricelli (2010) produced the first paper that highlights thus far largely-neglected relationship between SP and financial development in LICs. They show that SP, especially in the form of cash transfers can improve access to financial services, which may lower banking account fees, which, in turn, drive financial deepening, improve access to finance and lower the costs, and increase the efficiency of SP delivery, while promoting growth. Albeit intuitive, these links are still largely unexplored.
- The pension reform literature particularly emphasizes the positive effect of some forms of financing pension savings to the performance of financial markets (Corsetti and Schmidt-Hebbel 1995).
- Cross-country comparisons of growth rates find significant and positive growth effects of 'active' social transfers, those that encourage participation in the labor market by recipients, but no reliable growth effects from 'passive' social transfers, those that simply redistribute purchasing power to specific groups such as the elderly (Arjona et al. 2003; Banerjee and Duflo 2004). On aggregate, these studies, which are severely biased towards OECD countries due to data constraints, find (small) negative impact of SP spending on growth. Arjona et al. (2003) shows that expanding spending on SP from 18.5% of GDP (their cross-country mean) to 19.5 would reduce GDP in the long term by 0.7 percent.
- In the most recent analysis of this type Zaman and Tiwari (forthcoming) redress the bias and include many more developing countries in a similar set up. They find that spending on social protection is positively associated with changes in growth until a certain level, and then it impacts growth negatively. The coefficient on the squared

SP spending term suggests that the optimal growth maximizing level of SP spending implied by the pooled regression specification is 6.6% of GDP, well below spending in most developing LICs and MICs. The result imply rather small magnitude of effects: moving from 0 to 2% of GDP spending on SP increases per capita growth rate of GDP by 0.1-0.4 percentage points.

***Do social protection system flaws encourage informality or misallocation of resources?***

There is a traditional concern that social protection can distort choices of economic agents and provoke resource misallocation:

- Levy (2007) for the case of Mexico looks in great detail on possible negative effects of SP (more precisely uneven costs of benefits of SP for economic actors across sectors) on growth of the economy. Workers in the formal sector pay social security taxes and receive medical and other benefits. In contrast, informal workers now get health care that is of lower quality than that offered by social security, but free of cost. This difference in incentives across sectors affects investment decisions and locks some workers and entrepreneurs into low-productivity informal sector that is inefficiently large and constitutes a drag on economic growth. However, these SP-induced effects are not very large; they are smaller than the impact of other incentives for workers to stay informal (e.g., due to VAT tax collections – see Brooking Institution 2008).
- Aterido and Hallward-Driemeier (2010) describe the Seguro Popular (SP), a social program introduced by the Mexican government in 2002 to provide health insurance to the 50 million Mexicans without social security coverage. The program has also raised a debate (see Levy 2007 above) on whether it has had unintended consequences and distorted incentives facing workers, encouraging them to operate in the informal sector. Their paper provides an empirical test of the impact of SP on workers' decisions. Authors find that the effects on informality are indeed present and are likely to increase over time, with an accumulated effect after 2 years of 1.2% of additional households staying informal due to the program.

- Martin and Scarpetta (2011) look at the recent empirical evidence on the links between regulations affecting the hiring and firing of workers, labor reallocation and productivity growth. They show that employment protection has a sizeable effect on labor market flows and these flows, in turn, have significant impacts on productivity growth; less employment protection encourages greater growth. But adequate safety nets for the unemployed and effective re-employment services are needed as part of the “package”.
- Scarpetta and Tressel (2004) demonstrate using model and data from OECD countries potentially strongly negative impact of employment regulations on innovations capacity.
- Peracchi et al. (2007) propose the measurement approach using Bulgaria and Colombia as cases.
- On pensions, there is some empirical evidence using substantial variation in pension systems across countries. For example, the level of economic resources among retirees in Germany and in the United States is similar but the sources are quite different: in Germany about 85% of retirement income comes from public pension; In the United States just 45% comes from Social Security. Hurd et al (2008) show that that public pensions do displace private savings, but the resulting macroeconomic effects are probably small (ILO 2011).
- However, in the OECD countries there were several empirical studies documenting the presence of such effects. Lindert (2007) makes an eloquent point that these findings are grossly exaggerated and oversold:
- *“The usual tales about the high incentive costs of the welfare state are based on a compelling economic logic. The logic might have been borne out in the real world if governments had blundered by simply taxing capital and entrepreneurship and effort heavily, while offering young adults the chance to avoid a lifetime of work with a near-wage benefit. Yet the overriding fact about such blunders is that they never happened. Only if we extend the econometric estimates out into a world that never happened, a blundering world that taxes 40% of capital and top incomes and pays people who never work, would some of the estimated equations predict those high*

*cost of foolish policy. Within the range of true historical experience, there is no clear net GDP cost of higher social transfers.”*

***III(c). Effective social protection enables bold efficiency enhancing reforms (that eliminate rents and distortions)***

This point was made theoretically by Perotti (1993) and by now there many examples that show transformational and enabling role of social safety nets. Changes in Latin America social policies following the debt crisis of the 1970s and 1980s were motivated by this factor: Chile introduced a large public employment program in 1975 accompanying deep reforms in the economy, Bolivia instituted an emergency fund in 1987 to protect the poor. Many reforms in transition economies in ECA explicitly engaged at times quite sophisticated compensation schemes through social protection measures, notably pensions and safety nets. For example, in South Korea, social protection was strengthened in the 1990s to win workers' support for the introduction of greater labor market flexibility, including significant numbers of lay-offs (DFID 2006).

Safety nets create legitimacy for responsible economic policies. An influential report by the Growth Commission assembled policymakers from a dozen of fast growing countries. The report strongly emphasized the vital political role of safety nets. Countries included in the report- from Botswana to Ireland - show very different degree of inequality, but they all share the commitment to the equality to opportunities. To highlight the role of this commitment the authors of the report use Albert Hirschman's metaphor of a two-lane traffic jam. If one lane begins to move, drivers in the other at first take comfort, inferring that their lane will also move soon. But the longer they remain stuck, the more frustrated they will become. The other lane becomes a provocation, not a consolation. If one group is persistently and flagrantly excluded from the fruits of growth, the chances are they will try to force their way into the other lane, disrupting traffic in both. Safety nets are essential devices for governments to signal their commitment to equality of opportunity.

- Transition in CEE countries (SP facilitated restructuring and reallocation of labor and thus helped the growth rebound. For example Keane and Prasad (2000) argue that

generous pension transfers were reducing inequality in Poland and by reducing resistance to market-oriented reforms were enhancing growth; Rutkowski et al.; (World Bank, 2005b); Boeri and Terrell (2002) and Garibaldi and Brixiova (1998) provide strong evidence on the instrumental role of redistribution through SP programs as factor promoting reforms.

- Mexico's compensatory measures introduced along with the NAFTA showcase the pairing of safety nets and policy reforms (PROCAMPO in 1990s). Similar examples can be seen in Indonesia's energy subsidies reform (2005 and 2008), Brazil's reform of gas subsidies, and Ghana's revision of energy subsidies (G20).
- The social pension in Mauritius is believed to have been a major contributor to the social cohesion necessary to support the transition from a vulnerable mono-crop economy with high poverty rates into a high growth country with the lowest poverty rates in Africa (Roy and Subramanian 2001).
- Likewise, Botswana's social pension provides the government's most effective mechanism for tackling poverty and supporting the social stability that encourages the high investment rates required to drive Africa's fastest growing economy over the past three decades (OECD).

***III (d). Social protection reduces social tensions, crime and improves investment climate; rebuilding conflict states by providing public goods and mitigating risks.***

Predictable transfers constitute a social contract that binds a government to its citizens. Social protection can reduce social conflicts and criminality, and ease necessary reforms in mitigating their negative effects. Lower inequality and greater social stability also support greater productivity and economic growth. Social protection reduces insecurity, counterbalances the need to resort to extralegal or illegal methods of income generation, reduces the potential for social unrest and, hence, creates social prerequisites for long term profitable investments. Many studies indicate that crime rates and social conflicts are highly correlated with unemployment, income inequality and poverty (Fajnzylber et al. 1998; 2000). Social protection by reducing poverty and inequality can therefore reduce crime and

violence. The theoretical argument on the role of Social transfers in improving the chances for good resolution of social tensions is provided by Sala-i-Martin (1995) model, Rodrik (1998) for OECD countries.

Germany after the reunification and South Africa after the end of the Apartheid regime provide two successful examples of the contribution of social protection to nation building. In the European case, de Neubourg (2009) concludes that universalist benefits (e.g., unconditional cash transfer for all children/families) contributed most to national stability. Similarly, post conflict states can benefit from SP systems. Such states face severe development challenges such as weak institutional capacity, poor governance, political instability, and ongoing violence of various forms (Harvey et al. 2008). Aid, and more broadly development projects, has the potential to promote sustained post-conflict peace by stimulating broad-based growth and employment. The converse is clearly true as well in that long-lasting peace is a pre-condition for sustained growth (Collier and Hoeffler 2002).

- In the occupied Palestinian Territories, donors have been supporting the payment of social allowances to the poorest segment of the population and to key workers delivering essential public services since 2006. This substantial donor support is explicitly at the core of a strategy to build the legitimacy of the Palestinian Authorities (see EU 2010).
- Hendershon and Pietzch (2008) discuss explicitly what features cash transfers ought to have in order to rebuild social cohesion in conflict torn communities in Kenya.
- Porteous (2010) reports on the practice of using cash transfers to re-integrate refugees back into their communities in Northern Uganda.
- USAID has accumulated a large body of evidence in using humanitarian food assistance to maintain peace and cohesion  
([http://www.usaid.gov/our\\_work/humanitarian\\_assistance/ffp/index.html](http://www.usaid.gov/our_work/humanitarian_assistance/ffp/index.html))
- In Liberia, as in Sierra Leone, the government put particular emphasis on youth employment, because providing economic opportunities to marginalized and

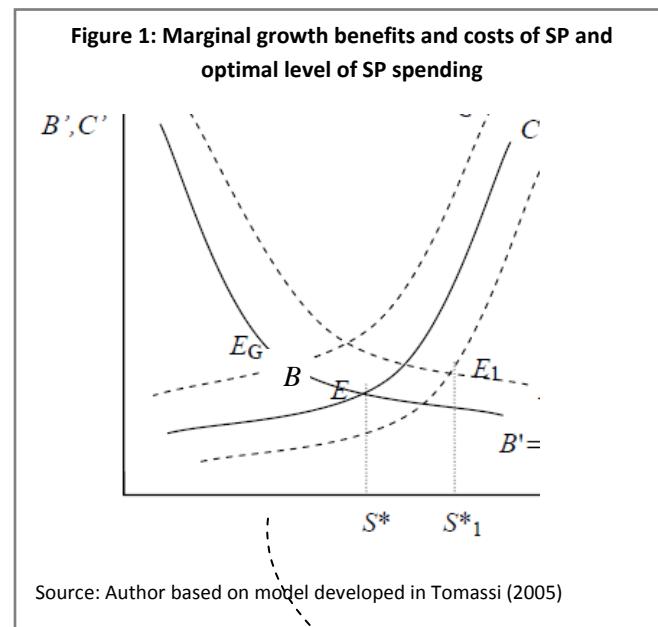
destitute youth groups (including ex-combatants) is key to their (re)integration into society, and thereby to social cohesion and stability. With international support both the Sierra Leone National Commission for Social Action (NaCSA) and the Liberia Agency for Country Empowerment have successfully implemented community-based public works projects. In 2010 the World Bank approved financing for two new projects: Youth, Employment and Skills in Liberia and the Youth Employment Support Project in Sierra Leone. The AfDB has also supported the NaCSA in Sierra Leone since 2003, and has recently started implementing a labor-based public works project in Liberia (EC 2010).

In-kind social transfers can also play an essential role: during the **Côte d'Ivoire** conflict, World Food Programme school feedings were credited with mitigating the impact of the crisis on children (WFP 2008)

#### **IV. BRINGING IT TOGETHER: COST AND BENEFITS OF SOCIAL PROTECTION**

To see the limitations of available data on costs and benefits, we propose a framework which follows the widely accepted logic proposed by Barro (1990). In his model, income taxes diminish capital accumulation and growth, but a publicly provided capital goods (such as infrastructure or facilitation of human capital investment) financed from taxes increase economic productivity. The model predicts a hump-shaped relationship between the size of government and growth. At low levels of taxation, the government can increase growth by raising tax and spending rates. At one level, the higher provision of public goods enhances the returns to private investment (crowding in). However, as taxation rises to very high levels, growth declines as the distortions to output outweigh the benefits of productive public spending.

This simple observation implies that there is an optimal level of spending



for SP (from purely economic growth perspective), at which the marginal benefits in terms of additional growth equate marginal benefits in terms of distortions. On Figure 1 there are two curves  $CC'$  (increasing marginal costs, vertical axis) and  $BB'$  (decreasing marginal benefits) which intersect at  $E$  giving the optimal level of social spending  $S^*$ . The total excess value of benefits over costs is then given by the triangle  $BEC'$ , which is maximized at  $S^*$ . Note, however, that benefits exceed cost (so cost benefit ratio is above 1) even for the point  $S^*_1$  where there is too much spending as well as in point  $S^*_2$  where there is not enough. Therefore we need to know the cost and benefits of marginal spending on SP – that is of expanding SP beyond the existing level (e.g. McCord and Van Scenter 2004 for a rare example).

But we can also go a step further and challenge the assumption that curves  $BB'$  and  $CC'$  are the same for every context. In fact we know that costs in terms of lost growth are related to the way SP is financed.<sup>14</sup> In less capacity environment there is more need to rely on distortionary taxes and tariffs. There is also a higher risk of corruption and fraud. Hence, the cost curve may shift upward (dotted line), and the equilibrium point  $E_G$  with spending  $S^*_2$ , where marginal benefits have to be higher than in a “benchmark” state  $E$ . Due to higher costs of course the total benefit cost ratio will shrink, but it is no longer true that the “right” level of spending is  $S^*$ . Due to the lack of complementary inputs/capital etc. the benefit curve can also shift (down), and the new equilibrium point will become  $S^*_3$ , where the level of spending is way lower, but marginal benefit and costs are the same. There is also an opposite case possible where cost are lower and benefits are greater and the optimal level of spending  $S^*_1$  shifts all the way to  $E_1$ .

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<sup>14</sup> Note that the deadweight costs of taxation are an issue for all expenditures. It is a general principle of public finance that the source of financing is separate from the category of expenditures. The former is fungible. There are specific costs in terms of subsidies but that is different. The costs of corruption, etc. are treated as other costs – for a benefit cost calculation they reduce the benefits for a unit expenditure but are not difficult to handle. The figure illustrates taxes and expenditures that are large enough to move the macro- economy while benefit cost generally assumes a smaller project.

Hence, using the universal benchmarks for cost/benefit rate or marginal levels cannot lead us to the correct assessment of the proper level of spending for a particular country. It has to be specific to each country context (and its specific design of SP).

However, a growth lens is not adequate for arguing the case for SP since SP has multiple objectives, such as reducing poverty or attaining greater equity alongside growth. It is therefore impossible use this approach exclusively to compare SP versus other forms of public spending.<sup>15</sup> But cost effectiveness analysis can assist in comparing alternatives within SP where “other objectives” are comparable.

One of the first applications of cost-benefit analysis of income growth to social protection program in the developing world was for education impacts and subsequent increase of human capital for beneficiaries (Coady and Parker 2004). Additionally a few studies have compared the relative effectiveness of school feeding programs (Alderman and Bundy, forthcoming). There is also a large literature on early childhood development and nutrition exploring this pathway for several countries and globally (see Alderman and Behrman 2004; Hoddinott et al. 2008; Horton et al. 2010; WFP 2011).

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<sup>15</sup> SP interventions have multiple objectives. At least two are present here: poverty reduction (in greater equity) and economic growth. Look at only on growth would implicitly assign zero value to the other objective. Say an investment can give a return of  $X$  while an equal value of social transfer can give a return of  $a$  [ $a < X$ ] but also increases consumption of the poor which has a value of  $b$  [ $b < X$ ] (in terms of welfare gains from redistribution). The question of interest is whether  $(a + b) >$  or  $< X$ . Unfortunately, it is difficult, if not impossible, to quantify  $b$ . However, it is misleading to assume that  $b$  is zero. If we focus only on  $a$  we will be underestimating the total returns. That is, any attempt to present a SP project *only* in terms of growth places it at a severe disadvantage.

**Figure 2: Benefits and Costs: Investing in Human Capital**

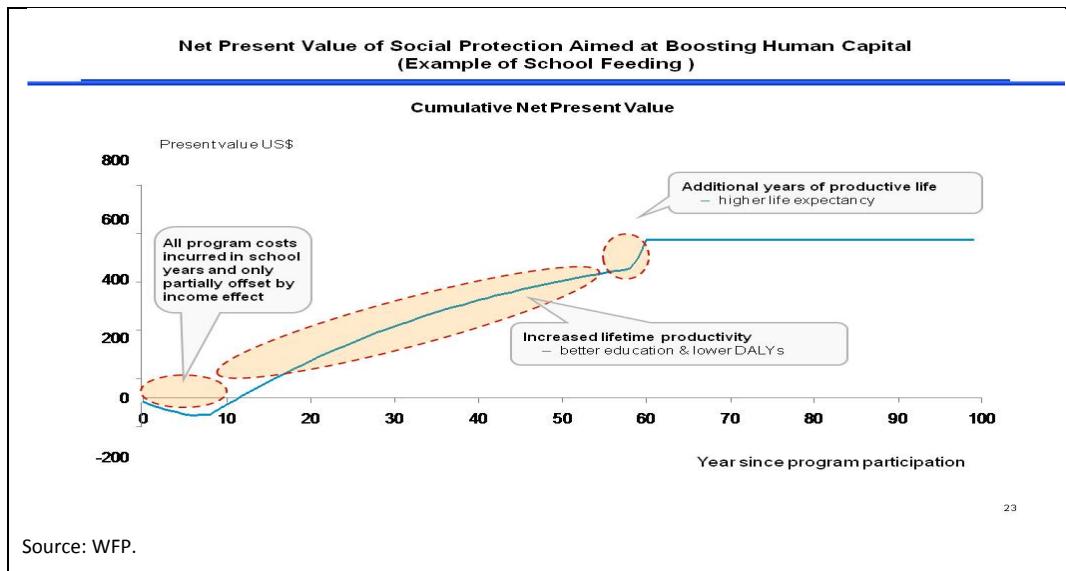


Figure 2 shows an illustrative example of how the benefits and costs of an investment in human capital in early years of life are estimated. It is useful to represent it in the form of net present value of social protection investment. There is a current cost component that tends to outweigh benefits, but the future income stream from increased earning capacity by far exceeds costs and generates additional growth for both participants and for the economy. The estimates of such growth effect critically depend on: (i) the value of additional human capital created by participating in the program, (ii) future returns on this human capital (which can vary in rather large range), (iii) discount factors. The existing good practice is to test the results under a wide range of assumptions, producing a vast array of possible effects for any given intervention. Hence, most authors contend with rather general statements on “positive” net present value reflecting additional growth, and not exact figures.

**Conclusion: Practice on productive role of social protection.**

There are several clusters of social protection programs where the productive aspect of SP is used explicitly in the design, implementation and evaluation (Table 3). These include:

- Micro- level, the CCTs which emphasize human capital, nutrition (or food assistance) programs and longer-term development goals, and various saving schemes (including micro-credit) which often are combined with transfers offering households a package of financial services to save, invest and insure their livelihoods;
- Meso level, perhaps the most visible (and famous) example of productive safety nets include public works which emphasize the productive value for communities of assets created. Ethiopia's PSNP largely follows this model. There is also growing practice of using school feeding programs to jump start local agricultural production and income generating activities as well as to advance education in the manner of a conditional transfer;
- Macro- level the most common use of SP in developing countries is in enabling growth-enhancing reforms evolving redistribution; universal subsidies reform is the most common example of using SP instruments to make reform politically feasible.

Table 4 presents available sources and how this knowledge is used in the design of policies and programs.

These practices as well as some other examples discussed above show both gaps and areas of strengths. It is important to note here that some large existing social protection programs aim to incorporate multiple channels of impact into an integrated design (e.g. use risk protection element and building local assets in PSNP in Ethiopia, or offering saving schemes for CCT recipients). Some evaluations have shown that there is scope for improving design of CCTs to maximize synergies with productive activities at the household level, and to maximize the impact of transfers on local economic development (Handa and Davies 2006). This is the direction the practice is taking.

**Table 4: Productive Impact of Social Protection: Strengths and Weaknesses of Evidence and Current Practice**

Effect/Channel	Types of programs	• Countries with strong evidence
<b>Micro: enables households to invest</b> In human capital In other HH productive assets and savings In higher risk/higher return activities	CCTs, ALMP, SF/THR, FA, MC, CTs, NCP, IV, MC, UB, CTs	Bangladesh, Bolivia, Brazil, Indonesia, Kenya, Malawi, Mexico, South Africa
<b>Meso: local economy effects</b> Investment in productive community assets Increased demand and local spillovers Addresses labor markets failures	PWs, CDD SF, CP, CDD, IV, ALMP,	Argentina, EU, India, Kenya, South Africa,
<b>Macro and political economy effects</b> Automatic stabilizers/multipliers Increases national savings Allow governments to enact reforms Improve social cohesion/reduce crime	Any CP, NCP, MC CTs, CCTs, CTs, CDD, ALMP,	Brazil, Chile, Democratic Republic of Congo, El Salvador, Indonesia, Liberia, Mexico, Philippines, South Africa, United States

APML=active labor market policies ; UB=unemployment benefits ;CDD=community-driven development ; MC= Micro-credit; CCT=Conditional Cash Transfer; ES=Wage/Employment Subsidies; FA=Food Aid; FCA=Family/Child Allowances; GS=General Subsidies; HEW=Fee Waivers for Health and Education; CP= Contributory Pensions; NCP=Noncontributory Pension; SF/THR=School Feeding/Take Home Rations; CTs=Unconditional Cash Transfer/Basic Transfer; PW= Public works/Workfare; IV- input vouchers.

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## Abstract

The paper contains a short theoretical framework for linking social protection with growth and productivity, an updated review of the literature, new original work filling in gaps in the available evidence, and a discussion of operational implications. The paper demonstrates that there was a shift in the economists' view on social protection, and now they are seen as a force that can make a positive contribution towards economic growth AND reduce poverty. The paper looks at pathways in which social protection programs (social insurance and social assistance programs, as well as labor programs) can support better growth outcomes: (i) individual level (building and protecting human capital, and other productive assets, empowering poor individuals to invest or to adopt higher return strategies), (ii) local economy effects (enhancing community assets and infrastructure, positive spillovers from beneficiaries to non-beneficiaries), (iii) overall economy level (acting as stabilizers of aggregate demand, improving social cohesion and making growth-enhancing reforms more politically feasible). Most social protection programs affect growth through all of these pathways. But the evidence is very uneven; and there are knowledge gaps. The paper discusses operational implications for the design and implementation of SP programs and proposes a work program for addressing knowledge gaps.

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