Australian Government
Department of Foreign Affairs and Trade

BRIEFING

Social protection and growth

Key messages

- **Evidence is overwhelming of the positive impacts of social protection on household productivity and labour market participation in developing countries.** Social protection includes productive programs and programs primarily protecting consumption. Both types promote investment in and diversification of livelihoods and employment. They also improve future prospects through investment in better nutrition and access to health care and education.
- In the face of shocks, such as natural disasters, rising food and fuel prices, ill health or the loss of employment, **social protection plays an important role in limiting the need for negative coping strategies that can reduce growth**, such as selling productive assets and removing children from school.
- **Social protection has positive impacts on growth at a local level** through the multiplier effects of increased local consumption and improving labour market outcomes. The impact of social protection on GDP is often insignificant in low and middle-income countries but likely to be positive if programs are at scale.
- **Social protection is an effective tool that allows governments to bring about other economic reforms that have positive effects on economic growth**, such as a reduction in inefficient commodity subsidies.
- Substantial evidence shows that **social protection in low and middle-income countries has no negative impacts on labour force participation or work effort and does not lead to dependency.**

Introduction

Economic growth is central to development and largely accepted as essential—if not sufficient—to increase prosperity and reduce poverty. At the same time, social protection has become increasingly important in poverty reduction efforts in developing countries over the last decade with growing investment in low and middle-income countries. Poverty reduction remains central to the post-2015 Millennium Development Goal agenda, with 'getting to zero' targets already being discussed for extreme poverty and a widespread commitment to the idea of 'leaving no-one behind'. Furthermore, renewed emphasis on growth and jobs within the international development agenda now, more than ever, focuses on inclusive growth that is sustainable and ensures the poor can participate in growth processes.

What is social protection?

In this briefing, social protection includes three common classifications of instruments.

Social assistance, typically cash or in-kind social transfers, subsidies or fee waivers targeted at low-income or vulnerable groups, funded out of general taxation or other (non-contributory) sources.

Social insurance, typically contributory or subsidised insurance (sometimes statutory) covering certain life contingencies including old age and loss of employment, and funded by employer or employee contributions.

Labour market programs, typically financial support, services and legislation concerned with improving employment opportunities and working standards.

While social protection programs can be assessed for their impacts on poverty and growth, it is important to remember that social protection's primary aim is to address poverty and vulnerability. This should not be subordinate to concerns with economic growth. It is therefore important to bring together knowledge on the effects of social protection on economic growth. It is also important to better understand through which channels these effects occur. This briefing summarises the links between social protection and growth and provides evidence on the nature of the impacts at household, local and national levels.

The potential links between social protection and growth

The growth and social protection literature identifies direct and indirect channels through which social protection may effect growth at household, local and national levels as shown in Table 1.

Promoting inclusive growth—social protection and household productivity

There is substantial evidence of the positive impacts of social protection on household productivity.

First, social protection can enable poor households to **accumulate productive assets and improve labour market participation**. It does so by supporting households to overcome the savings and credit constraints that prevent greater investment in livelihoods and to seek better employment. Households enrolled in Mexico's *Oportunidades* program invested about 26 per cent of transfers, increasing agricultural income by almost 10 per cent after 18 months of benefits (Gertler et al. 2012). Evidence exists that regular transfers to poor households can increase credit worthiness and thus access to credit for investment (IEG 2011; Scott 2009) and provide resources for job seeking. Brazil's *Bolsa Família* increased labour-market participation among beneficiaries by 2.6 per cent compared with non-beneficiaries, with women's participation 4.3 per cent higher than that of men (Oliveira et al. 2007 cited in Holmes & Jones 2013).

Second, there is increasing evidence that cash transfers enable households to **invest in higher return livelihoods strategies**. Normally, investment by poor households in higher return livelihoods strategies carries the risk of losses that would bring these households below the consumption level needed to survive. Long-term and predictable cash transfers provide households with some security against potentially catastrophic outcomes. Small-scale farmers in Maharashtra, India, for example, invested in higher yielding but riskier crop varieties as a result of their enrolment in the Maharashtra Employment Guarantee Scheme (Devereux 2002).

Third, social protection can help break the cycle of inter-generational poverty by overcoming the savings and credit constraints preventing households from **investing in human capital**. The child support grant and old age pension in South Africa have improved nutrition, health and height of children (Aguero et al. 2006; Samson & Miller 2012). Conditional cash transfers in Colombia, El Salvador, Honduras, Mexico, Nicaragua and Turkey have been found to increase enrolment rates by between 2 and 13 percentage points (IEG 2011).

Table 1: Social protection and economic growth framework

	Direct impacts on growth	Indirect impacts on growth
Micro (indivudal or household) level	> prevent loss of productive capital (+) > accumulate productive assets (+) > increase innovation and risk taking in livelihoods of poor households (+) > impacts on labour force participation (+/-)	> increase investment in human capital (+)
Meso (community or local regional) level	> multiplier effects from increased local consumption and production (+) > accumulation of productive community assets (+) > labour market impacts including inflation effects on local wages (+/-)	n/a
Macro (national) level	> cumulative increases in household productivity (+) > stimulate aggregate demand (+) > changes in aggregate labour force participation (+/-) > increase capital markets through pension funds (+) > effects of taxation on savings/investment (-) > effects of government borrowing and inflation (-)	> facilitate economic reforms (+) > enhance social cohesion and reduce inequality (+) > enhance human capital (+) > impacts on fertility rates (+/-)

Source: Author, drawing on Arjona et al. (2002); Grosh et al. (2008), Piachaud (2008); Alderman & Yemtsov (2012); Barrientos (2012).

Note: (+) potential positive impact; (-) potential negative impact; (+/-) possible positive or negative impact.

What is growth and what are its determinants?

Economic growth is the increase in the value of goods and services in an economy over time. The most common measure is the rate of change in GDP which represents the market value of all expenditure within a national economy over 12 months. However, GDP tells us nothing about unpaid contributions, such as domestic work, or about the distribution of income among the population. Other measures, such as average growth or the Gini index, can tell more about the nature of growth—its distribution between groups and the extent to which the poor participate in growth processes. It is also useful to consider growth at three levels:

> individual or household level changes in productivity and availability of (and access to) employment opportunities

> localised or community-level growth occurring in certain geographic locations of an economy

> national or aggregate economic growth.

No single unified theory of the underlying determinants of growth exists, but most well-known models point to three essential factors determining levels of productivity and economic growth levels: physical capital, labour or human capital, and innovation and technology. These elements may be influenced by policies and the legal, regulatory and macroeconomic environment, other formal and informal institutions (the rules of the game), demographic trends, political stability and levels of social cohesion. Social protection can itself be a determinant of growth and has been well studied for its effects on growth at household, community and aggregate levels (Arjona et al. 2002; Petrakos et al. 2007; Barro 2008; Grosh et al. 2008).

Fourth, social protection can help **prevent the loss of productive assets** and reductions in human capital following widespread and personal shocks as well as stresses such as natural disasters, rising food and fuel prices, ill health or the loss of employment. After large-scale disasters, existing social protection systems may be scaled up. Measures introduced in Indonesia in response to the East Asian financial crisis included targeted fee waivers for public health care, scholarships for poor children, and rice subsidies. Studies have shown that service use fell less among recipients (Grosh et al. 2008) and that the response was instrumental in stabilising consumption and reducing child labour (IEG 2011).

Impacts of social protection on local-level growth

There is a small but growing body of evidence of the local economy impacts of social protection. First, social transfers results in **multiplier effects in the local economy** from increased spending, consumption and production. This is particularly so for social protection targeted to poor households in small, self-contained local economies that tend to spend locally and on locally produced products (Arnold et al. 2011; Barrientos & Scott 2008). Taylor et al. (2013) found that Kenya's cash transfer for orphans and vulnerable children has increased real income in the local economy by 1.58 Ksh for every 1 Ksh transferred, with most additional benefits accruing to non-recipient households. Second, most public works programs result in the **creation of productive community assets**, such as roads, or projects related to land management, such as irrigation. However, while there is ample evidence of the construction of infrastructure, few studies examine the economic impacts. Anecdotal evidence suggests that the quality of assets produced is often poor and economic effects often marginal (Barrientos 2013; McCord 2013b). Third, public works and other labour market programs can help **improve the functioning of local labour markets**. Employment programs not only increase demand for labour, but can change the relationships between labourers and landowners. Poor households enrolled in Ethiopia's *Meket* Livelihoods Development Project were able to renegotiate sharecropping with better-off households (Adams & Kebede 2005, in Alderman & Yemtsov, 2012). These effects depend on the state of local markets, the scale of the program, and the size and regularity of the transfers.

Social protection, GDP and the direct and indirect aggregate growth effects

Evidence of the **effects of social protection on GDP** is still relatively weak, but suggests that programs in developing countries may have small positive impacts when operating at scale. Various studies of high-income countries in the 1980s and 1990s found that social protection increased growth, but other studies contradicted these findings (Arjona et al. 2002; Atkinson 1999). More recently, Arjona et al. (2012) found that increased spending on social protection by 1 per cent of GDP in OECD countries only moderately reduced growth by 0.7 per cent of GDP in the long term. However, a marginal increase in spending on programs primarily aimed at improving productivity and employment leads to a 1 per cent increase in GDP.

A handful of theoretical and empirical studies from low and middle-income countries, including Bangladesh and South Africa, suggest that social protection can have positive impacts on aggregate growth (McCord and Van Sventer 2004; Alamgir 1996; Mallick 2000). However these growth effects are small and in most cases indiscernible from natural variation in the measurement of growth. This is perhaps unsurprising given the low spending on social protection and the marginal share of income among the poorest in most low and middle-income countries. Nonetheless the potential for aggregate growth impacts will increase as programs are expanded. Mexico's conditional cash transfer program, *Oportunidades*, now reaches 25 million people, more than 25 per cent of the population (Grosh et al. 2008).

These growth effects are most likely the result of the cumulative increases in household productivity or labour participation discussed previously. However, there are various other direct channels through which social protection may affect aggregate growth.

First, social protection can **stimulate aggregate demand** by providing counter-cyclical spending during economic downturns. ILO (2011) suggests that countries with effective social protection systems responded better to the recent global financial crisis. Evidence from the United States' multi-billion dollar stimulus package in 2009 showed that expanding food stamps had a multiplier effect of 1.7, while investing in infrastructure and extension of unemployment benefits (1.6) (Zandi 2009). However, while evidence is substantial of the stimulus approach being employed by low and middle-income countries, evidence of its effectiveness is thinner (McCord 2013).

Second, social insurance schemes may affect aggregate growth through **increasing savings** and therefore deepening capital markets. Corsetti and Schmidt-Hebbel (1995) show how social protection, specifically pension insurance, can promote growth by providing capital to stock and bond markets, although pension reforms (moving from a state-run, pay-as-you-go scheme to fully funded private pensions) would only have marginal impacts on growth over the long term.

Third, in the event that governments borrow beyond their capacity to finance social spending, there is greater risk of **economic destabilisation** which deters investment. For selected European countries, Checherita and Rother (2010) found that when government debt reaches around 90 per cent to 100 per cent of GDP it begins to have a detrimental effect on long-term economic growth, however the size of these effects is uncertain. Nonetheless, while social protection spending cannot be seen in isolation from other government expenditure it is generally not advisable to fund the recurrent costs of programs through borrowing (Hagen-Zanker & Tavakoli 2011).

There are also a number of indirect channels through which social protection may affect aggregate growth.

First, there is significant evidence that social protection can help governments to **facilitate other economic reforms** that reduce inefficient government spending (Alderman & Yemtsov 2012). Indonesia reformed its fuel subsidy without significant social unrest, in part by introducing cash transfer programs funded by the savings (Grosh et al. 2008).

Second, strong evidence exists, mostly from high-income countries, of the long-term impacts of **healthier and better educated people** on productivity and growth (Weil 2005; Ashraf et al. 2009; Krueger & Lindahl 2000) for which social protection can be instrumental in tackling demand-side barriers to basic goods and services.

Third, while there is little evidence of the impacts of social protection (positive or negative) on state-building and **social cohesion** (Babajanian 2012; Carpenter et al. 2012), there is growing consensus that the role social protection plays in reducing inequality is positive for economic growth, especially in developing countries (Ravallion 2005; Barro 2008; Arjona et al. 2002) because the poor and near poor have better opportunities to participate in growth processes (Grosh et al. 2008). Finally, certain social protection instruments such as child grants or pensions may have **effects on fertility**. Evidence of this, and of the economic effects of fertility on growth, is relatively weak and it is not possible to draw firm conclusions.

Conclusions

This briefing has examined the evidence of the impacts of social protection on growth at macro (national), meso (community or local regional) or micro (individual or household level) and through direct and indirect channels. More research is required on the extent to which these channels may affect economic growth at aggregate level, specifically in low and middle-income contexts. This research should aim to clarify if—and to what extent—certain objectives often attached to social protection programs are borne out in practice (for example, economic empowerment and social cohesion). Other research should focus on the growth impacts of the assets created through public works programs, and on approaches to social protection that maximise productivity and enable beneficiaries to become less risk averse and create new sources of income for themselves.

Despite these gaps, existing evidence suggests that social protection is an important policy tool for low and middle-income country governments, not just for alleviating poverty and reducing vulnerability but for promoting inclusive growth. Understanding and assessing the growth-enhancing impacts of social protection and identifying the most appropriate design and implementation features to achieve this should form part of policy and program decisions.

The full Social Protection Paper *Research Synthesis—Social Protection and Growth*, including references, is available at www.dfat.gov.au