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Can low-income countries afford basic social security?

The Social Security Department of the International Labour Office (ILO) is the unit through which the ILO provides technical assistance and advice to its member countries in the area of social security policy and governance; develops policies to support the extension of social security to all and social inclusion; promotes international social security standards and develops and disseminates tools to support the effective governance of social security schemes.

In 2001, the International Labour Conference (ILC) reached a consensus that high priority should be given to policies and initiatives to extend social security to those who are not presently covered. Accordingly, the ILC directed the ILO to launch a major campaign to promote the extension of social security coverage. The Social Security Policy Briefings series is produced in the framework of the Campaign; it aims to set out the views of the Social Security Department in areas of particular importance, and so provide guidance to ILO member countries in the formulation of their social security policies.

It thus complements the existing Issues in Social Protection Discussion papers series and the Extension of Social Security series published by the Social Security Department by making available a comprehensive set of information tools.

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SOCIAL SECURITY POLICY BRIEFINGS

Paper 3

Can low-income countries afford basic social security?

Global Campaign on Social Security and Coverage for All

Social Security Department
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Abbreviations

GDP	Gross Domestic Product
ILO	International Labour Office
IMF	International Monetary Fund
OECD	Organization for Economic Co-operation and Development
PPP	Purchasing Power Parity
UN	United Nations
WHO	World Health Organization

1. Introduction: The case for a basic social security floor

Social security is a human right

Article 22 of the Universal Declaration of Human Rights states: "Everyone, as a member of society, has the right to social security" and Article 25 formulates it in a more precise way as "...the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control". But almost 60 years after its adoption, this right remains a dream for 80 per cent of the global population, who are still without access to social security.[1] We know that to many, even a basic set of benefits could make the difference between a liveable and a miserable life, often between life and premature death. Millions of children under five die every year because they have no access to adequate health care and there is no income to secure their food.

Current levels of poverty and inequality are unacceptable

At the beginning of the 21st century, half of the world lives below the two-dollar-a-day poverty line. According to the United Nations (UN), the richest 10 per cent of the world's adult population receives 85 per cent of global wealth; in contrast, the poorest 50 per cent barely gets 1 per cent of it. Given that the benefits of global economic growth do not automatically reach all, a Global Social Floor is indispensable to ensure a social dimension to globalization.

Basic social security reduces poverty faster

We know very well that social protection is a powerful tool to prevent and alleviate poverty and inequality. Social security systems in many developed market economies reduce poverty and inequality by half or more. There are also a growing number of successful examples regarding the role of social transfers in combating poverty in Africa, Latin America and Asia, delivering much faster results than the ones expected from a trickle-down effect from economic policies. For a low-income country, even a basic social security system can make the difference between achieving or not achieving Millennium Development Goals (MDG) 1 of halving poverty by 2015, it can enhance the achievement of other MDGs and would contribute to the Decent Work Agenda.

It generates growth

Social security transfers serve as cash injections to local economies, having a positive impact on their development. Raising the incomes of the poor it increases domestic demand and, in turn, encourages growth by expanding domestic markets. At the

[1] The term "social security" and "social protection" have been used interchangeably within the present document. In the literature and public debate on social issues, the term "social security" which widely used for decades, is often understood as the set of transfers that originate from formal sector employment. "Social protection" is considered to be a wider concept (Cichon et al., 2004).

macroeconomic level, a growing number of evidence show that redistribution has a positive effect on growth in particular in countries where inequalities are high (AFD 2004). The net costs of early investments into a basic set of social security benefits may even become zero or negative, because the fiscal costs might be offset by positive economic returns and the enhanced productivity of a better educated, healthier and better nourished workforce.

It promotes peace, stability and social cohesion through social justice

Poverty and gross inequities, and their associated intense social tensions, are more likely to result in violent conflict, ultimately destabilizing governments and regions, causing waves of irregular migration, and may make people more susceptible to terrorist appeals and acts and other forms of criminality. Social security measures by preventing and alleviating poverty and by making the outcomes of economic forces more equitable enhance peace, stability and social cohesion. Providing social security is one of the most effective policies that a state can implement to gain legitimacy and to provide stability in post conflict situations.

It is an indispensable part of the institutional tissue of an efficient market economy

Development experience of all now developed market economies proved this to be true. There is no successful market economy that does not have a fairly extensive social security system. Social security systems have been there as part of the societal fabric supporting the national development process. Market economies with missing or weak institutions, including institutions of social protection/security are not able to ensure sustainable economic growth and social development in the globalizing world.

The costs of keeping people excluded will be higher and higher

Maintaining 80 per cent of the world population without basic social protection translates into continuing poverty, increasing inequality and the growing likelihood of conflicts. Among children, poverty and malnutrition damage health, reduce body weight and intelligence, resulting in lower productivity in adulthood, a high tax for a country to pay. At the international level, globalization will find further resistance, as this unprecedented creation of wealth benefits few; for globalization to be accepted, it needs to deal with its social aspects: it needs a global social contract. Part of such a contract would be a new, internationally accepted, Basic Social Security Floor.

The Basic Social Security Floor

The Basic Social Security Floor is a part of the concept of a Global Social Floor or Global Socio-economic Floor that was promoted *inter alia* by the World Commission on the Social Dimension of Globalization in 2004 (World Commission on the Social Dimension of Globalization 2004, pp 110). These concepts also contain a base of social and economic rights that are outside the realm of social security.

The Basic Social Security Floor, as defined here, consists of a basic and modest set of social security guarantees – implemented by social transfers in cash and in kind - for all citizens ensuring that ultimately:

- All residents have access to basic/essential health care benefits through pluralistic delivery mechanisms where the State accepts the general responsibility for ensuring adequacy of the delivery system and its financing;

- All children enjoy income security at least at the poverty level through various family/child benefits aimed to facilitate access to nutrition, education and care;

- Some targeted income support for the poor, unemployed in the active age group;

- All residents in old age or with disabilities enjoy income security at least at the poverty level through pensions for old age, disability and survivors.

The Basic Social Security Floor thus consists essentially of a guaranteed set of basic social transfers in cash or in kind to all. It is formulated as a set of guarantees rather than a set of defined benefits. This leaves the option open to individual countries to realize these guarantees by way of means-tested, conditional or universal transfers. The essential fact is that everybody in a given society can access these essential transfers. While conceptually these are a part of the country's social security architecture, the benefits provided would most likely have the character of social assistance rather than social security benefits in most countries. It is assumed here that most likely the basic/low benefits are financed from general taxation. The transfers of the social floor are granted to all residents as residents' rights, thus their financing is generally a responsibility of the society as a whole. Social security benefits on the other hand usually are the result of rights acquired on the basis of payment of contributions or taxes and usually of a high level of income replacement.

All countries have some form of social security but few, outside of members of the European Union (EU) or other high-income members of the Organization for Economic Co-operation and Development (OECD) countries, provide a basic social security floor for all. Typical reasons for this severe undersupply of social protection include the lack of understanding of the benefits of investing in people, limited technical capacity, lack of resources and low political will. These need to be urgently addressed. The idea of a Basic Social Security Floor has to be gradually translated into an internationally agreed standard and then into national legislative provisions.

In particular, the results of research and experience of the International Labour Office (ILO) and that of other development institutions show that the crucial prerequisite for the implementation of the Basic Social Security Floor in developing countries is to ensure that governments and other stakeholders understand that it can be fiscally affordable and does not have a substantial economic opportunity cost.

It is affordable

We know that the world can afford to make the right to social security a reality not just a dream. According to ILO calculations, less than 2 per cent of global Gross Domestic Product (GDP) would be necessary to provide a basic set of social security benefits to all of the world's poor. Six per cent of global GDP would be needed to provide a basic set of benefits to all who have no access to social security. That investment in people is less than 10 per cent respectively 30 per cent of the total global investment in tangible assets. Most of the resources needed will obviously have to come from national resources. The analysis in this note shows that this should be possible.

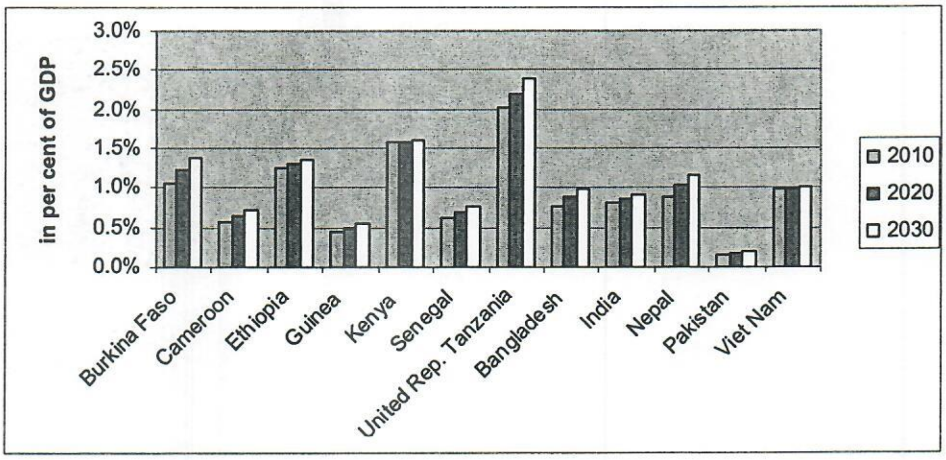
Proposals to accelerate the establishment of social protection systems in low-income countries have gathered strength in the early years of the millennium. These proposals are being subjected to searching questions. One major question concerns "affordability" – with which the rest of this paper seeks to deal.

The question of affordability has to be considered in the context of the fiscal and broader economic environment at the national level (Cichon et al. 2004). In addition, it is important to consider national institutional capacities and governance aspects. However, one has also to consider the international context with respect to the need to ensure that global competition does not drive countries and their populations below agreed minimum labour and social standards, and to obtain international support in financing provisions of minimum basic social protection in low income countries during the transitory period until these countries have the necessary domestic fiscal capacity to do so themselves.

share of total government expenditure unchanged. The estimated current shares are rather low but differ substantially among countries: for example, 0.8 per cent in Pakistan and 8.4 per cent in Tanzania.

Under such spending policy, governments would be able to finance from available domestic resources the modelled basic social protection package only up to the given amounts expressed as percentages of GDP in Figure 7. Due to its low current expenditure levels, Pakistan would spend only up to 0.2 per cent of GDP on basic social protection in 2010, slightly rising over time. Countries like Cameroon, Guinea and Senegal could reach spending levels around 0.4-0.6 per cent of GDP. A third cluster of countries is found with spending levels around 1 per cent of GDP: Bangladesh, India, Nepal and Viet Nam joined by Burkina Faso, Ethiopia and Kenya at 1.0-1.6 per cent of GDP. Tanzania stands out with spending levels of 2.0 per cent of GDP, which reflects high current expenditure levels on basic social protection. The outcome would be as varied and as unrelated to national needs and international standards as government expenditure is today.

Figure 7. Projected domestically financed expenditure on basic social protection as per cent of GDP, (Status quo: 2003 spending level held constant over time) for selected countries in Africa and Asia (selected years)

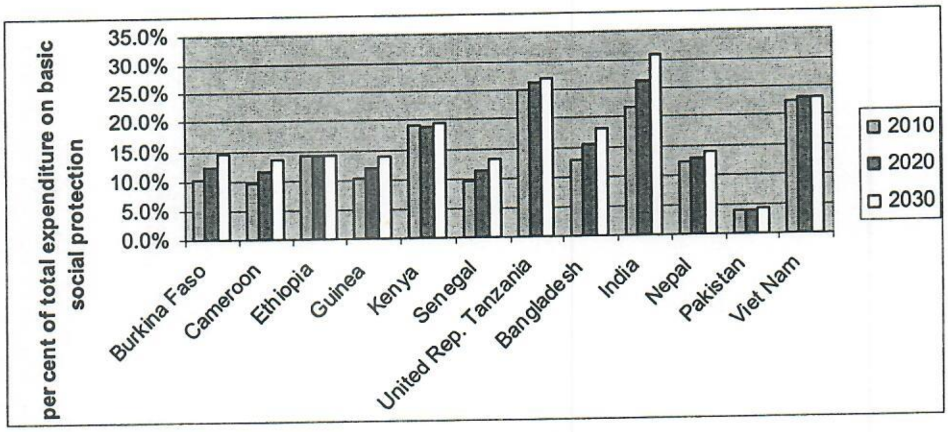


Source: Based on Pal et al., 2005; Mizunoya et al., 2006; own calculations.

However, the total cost of the basic social security package that we have constructed (Figure 5) is much higher than the estimates of future resources that are likely to be available – shown by projecting current levels of spending in line with economic growth. (Figure 7). Therefore, if countries are not in a position to break out of the low levels of social protection expenditure within their available domestic resources, they will need to draw heavily on external sources of funding to implement basic social protection.

Figure 8 shows what share of government expenditure is covered by the basic social protection package under the above spending policy assumptions. While Pakistan would cover in 2010 less than 4 per cent of the total estimated costs, countries such as Burkina Faso, Cameroon, Guinea and Senegal would shoulder approximately 10 per cent of the total estimated costs. Countries like Ethiopia, Kenya, Bangladesh and Nepal would cover between 10-20 per cent while India, Tanzania and Viet Nam could shoulder more than a fifth of the estimated costs in 2010, quickly increasing in the case of India to one third by 2030. In all countries, the capacity to increase the share of domestic financing increases over time, but remains insufficient to cover the basic social protection package modelled above.

Figure 8. **Share of total cost of basic social protection package to be covered by domestic resources (Status quo: 2003 spending level held constant over time) for selected countries in Africa and Asia (selected years)**

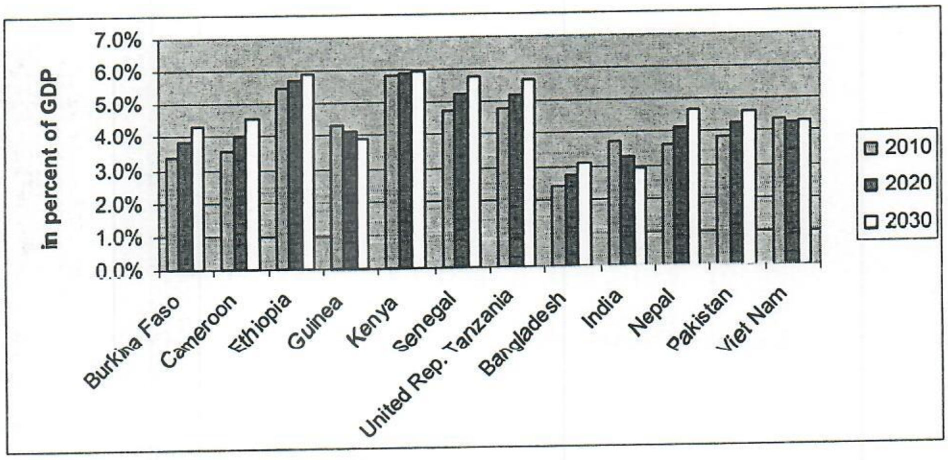


Source: Based on Pal et al., 2005; Mizunoya et al., 2006; own calculations.

2.2.2. Simulating policy change: Spending levels increased to one fifth of government expenditure

Under the second spending policy option, it is assumed that governments increase their allocations to social protection to one fifth of their total budget.

Figure 9. **Projected domestically financed expenditure on basic social protection in per cent of GDP (Simulating policy change: spending on basic social protection reaching 20 per cent of government expenditure) for selected countries in Africa and Asia (selected years)**



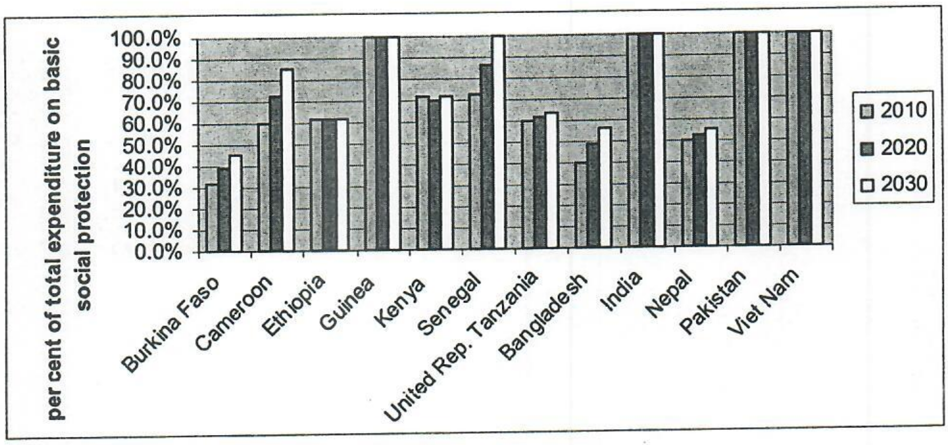
Source: Based on Pal et al., 2005; Mizunoya et al., 2006; own calculations.

When this alternative model is applied, domestically financed expenditure on basic social protection reaches levels of between 2.4 to 5.8 per cent of GDP in 2010 (see Figure 9). The lowest level is projected for Bangladesh, due to the relatively small volume of the government budget; yet the domestically financed social protection spending would rise from 2.4 to 3.1 per cent of GDP between 2010 and 2030. In Burkina Faso, Cameroon, India, Nepal and Pakistan the governments would be able to allocate from 3.4 to 3.9 per cent of their GDP to basic social protection in 2010, increasing these figures to between 4.3 and 5.0 per cent of GDP by 2030. In Guinea, Senegal, Tanzania and Viet Nam governments could allocate 4.4 to 4.8 per cent in 2010, with spending levels projected to reach between 3.9 to 5.8 per cent of GDP by 2030. The governments of Ethiopia and Kenya could invest 5.5 and 5.8 per cent respectively of GDP into basic social protection in

2010, increasing to 5.9 and 6.0 per cent of GDP by 2030. Guinea's relative level of domestic financing is assumed to decrease over time from 4.3 per cent in 2010 to 3.9 per cent of GDP in 2030 and India's relative level of domestic financing is assumed to decrease over time from 3.7 per cent in 2010 to 2.9 per cent of GDP in 2030. Guinea and India's results are related to the fact that the cost of the basic social protection package remains below the limit of 20 per cent of total government spending starting from 2013 for India.

Figure 10 shows that if Guinea, India and Viet Nam would increase the share of social protection spending in their total budget, by 2010 they would already be able to finance over 100 per cent of the universal basic social protection package domestically while for Senegal this would be possible by 2030. For other countries, even after such reallocation of domestic resources, there would still be a need to fill the substantial financing gap by international transfers. Countries like Bangladesh, Burkina Faso and Nepal could cover less than 50 per cent of the total financing needs by 2010. While their capacity to finance a basic social protection package is expected to increase over the following two decades, the share of domestic funding remains below the total needed, which implies that substantial external support would be necessary for some time. Tanzania starts off from the ability to cover 59 per cent of its financing needs domestically but is expected to increase its ability to finance basic social transfers domestically to 64 per cent by 2030.

Figure 10. Share of total cost of basic social protection package that can be covered by domestic resources (Simulating policy change: spending on basic social protection to reach 20 per cent of government expenditure) for selected countries in Africa and Asia (selected years)



Source: Based on Pal et al., 2005; Mizunoya et al., 2006; own calculations.

For a second cluster of countries, including Cameroon, Ethiopia, Kenya and Senegal the projections sketch a more optimistic picture. These countries would be in a position to cover 60-73 per cent of the total costs of the package by 2010 (i.e. if they were to devote one fifth of domestic resources to basic social protection). By 2030, 72 per cent (Kenya) and 100 per cent (Senegal) of basic social protection would be covered.

However, there is an interesting further option. If countries are able to finance about 50 per cent of all their health care by introducing a national health insurance system (like for example Ghana did in 2003) by 2010 then except for Burkina Faso, Cameroon, Tanzania, Bangladesh and Nepal all the countries would be able to shoulder at least 80 per cent of the cost of the basic social security floor by 2010.

3. The possible effects of social cash transfers on poverty reduction[8]

The ILO micro-simulation results presented in Gassman and Behrendt (2006) for Tanzania and Senegal show that a set of basic social protection cash benefits (old-age pensions and child benefits) can have an important effect on poverty alleviation and thus be an important component of poverty reduction strategies in low-income countries. The benefit levels which were fixed in relation to the poverty line in each country and represented for the old-age (60 years and over) and disability pension a level of 70 per cent of food poverty line per eligible individual (0.35 and 1.1 US$ PPP per day respectively for Tanzania and Senegal); and for child benefits a level of 35 per cent of the food poverty line per eligible child (0.17 and 0.53 US$ PPP per day respectively for Tanzania and Senegal). Furthermore, a benefit level equivalent to one benefit of 70 per cent of the food poverty line per household was assumed for vulnerable households, i.e. households without able-bodied household members (i.e. either under the age of 20 or above the age of 59, or sick or injured or handicapped).

Under such assumptions, the model demonstrated that in Tanzania a universal old-age pension would cut poverty rates by 9 per cent, with a considerably stronger effect – 36 per cent – for older men and women and 24 per cent for individuals living in households with elderly family members. A more balanced effect would be achieved by a child benefit for school-age children, which would result in a cut in poverty rates by around 30 per cent. The combination of these two benefits would achieve a reduction in poverty rates of 35 per cent, with even more substantial effects for individuals living in households with children and elderly (a drop of 46 per cent), which face the highest poverty risk. The targeted cash transfers achieve an overall reduction of poverty of 7 per cent, yet with a much stronger effect on older persons (minus 12 per cent and 18 per cent, respectively, for older women and men) and individuals living in households without able-bodied members (minus 46 per cent).

With respect to the poverty gap reduction achieved, the old-age pensions would reduce the poverty gap by 77 per cent for older women and by 65 per cent for older men while compressing the overall poverty gap for the total population by 17 per cent. Child benefits would reduce the poverty gap by about one-half across the board.

In Senegal the combination of a basic old-age and disability and a child benefit for school-age children would reduce food poverty rates by 40 per cent and reduce the poverty gap by more than half. While child benefits affect all groups of individuals to a somewhat similar extent, old-age and disability pensions have a more pronounced effect on older persons, especially on elderly women, and their family members. Targeted cash benefits show a major effect on households without able-bodied members, but only a minor effect on the overall poverty rate.

Thus, scarce national resources if used to provide cash benefits to vulnerable segments of the population can have a major effect on poverty alleviation and the achievement of the 2015 Millennium Development Goal of poverty reduction.

[8] Section taken from Gassman, F.; Behrendt, C. (2006).

4. Conclusion

The above projections were developed under rather conservative assumptions with regard to policy change and rigorous assumptions with respect to the fiscal policies of the countries in question. First, they were all assumed to depend only on revenue raised domestically (thus phasing out current external grants). Therefore the scale of transitional external finance required towards the basic social protection package is net of the projected deduction of such external flows. The idea is to either re-direct and/or increase current external support - to focus it on providing the very basic social protection package. This is intended to concentrate national attention upon anti-poverty priorities.

However, increasing national debt should be examined notably with regard to its potential impact on growth and to national capacity for servicing of the debt in the future. Grants depend in particular on the will of donors. They also depend on the current level of such grants and the general policy of governments such as for example the level of grants considered to be reasonable taking into account issues of sustainability, dependency and vulnerability. Initiatives to alleviate debt in the context of the Heavily Indebted Poor Countries Initiative (HIPC)/Multilateral Debt Relief Initiative (MDRI) and the Paris Club initiatives together with those to ensure predictability of aid such as the "Paris Declaration on Aid Effectiveness" constitute in that sense positive opportunities to increase external support to basic social security.

Increasing domestic revenues allocated to basic social security is determined by both the fiscal space and the political will to increase the share of public expenditure dedicated to this policy field. Capacity to create fiscal space should be considered in the context of a comprehensive medium term government expenditure framework. Key factors for creating fiscal space in low-income countries are determined by national capacity to mobilize additional revenue through increasing the tax base, by ensuring efficient use of resources as a result of strengthening public institutions and by promoting adequate policies to sustain productivity. Decisions to increase the share of public expenditure dedicated to basic social security will depend on political will and on the level of government budget already committed. To support the decision making process, overall feasibility, both financial and administrative, should be assessed and the projected outcomes of providing basic social security should be estimated. For the latter, evidence gained from existing programmes and from modeling exercises (see for example Gassman, F.; Behrendt, C. 2006) is very helpful.

Second, all the countries were assumed to cap their overall public expenditure at the level not higher than 20 per cent of government spending. Such an assumption was made to show what is possible within the framework of a relatively "small state" (as measured by the size of public finances). As countries develop and widen their tax base they may wish to go beyond "small state" and rather follow relative levels of government revenues and expenditure prevailing in the OECD countries. For the time being pressures of "tax competition" developing as part of the spontaneous globalization processes may prevent them from doing so. This however may change if global governance of the globalization processes is strengthened and agreement on a global social floor (which would include a guarantee of universal access to basic social security) is reached.

The evidence presented shows that low-income countries not only should but also can have social security systems that provide a basic package of health services to everybody, basic cash benefits to the elderly and families with children and social assistance to a proportion of the unemployed. Even if a basic social protection package cannot be implemented at once, a sequential approach can generate immediate benefits in terms of poverty reduction, pro-poor growth and social development. A national forward-looking social protection strategy can help to sequence the implementation of various social programmes and policy instruments and ensure that these are integrated in broader development frameworks. As these countries achieve higher levels of economic development, their social security systems can also advance in parallel, extending the scope, level and quality of benefits and services provided.

A basic social protection package is demonstrably affordable, as the costing exercise in this document shows. But this is on condition that the package is implemented through the joint efforts of the low-income countries themselves (reallocating existing resources and raising new resources, i.e. through health insurance or other earmarked sources of financing for social security) and of the international donor community - which would in some cases have to refocus international grants on the supplementary direct financing of social protection benefits, on strengthening the administrative and delivery capacity of national social protection institutions in low income countries and on providing the necessary technical advice and other support. All these steps have started to be taken in a number of low-income countries in Africa and elsewhere (recent developments in countries like Tanzania, Zambia, Mozambique or Nepal are just a few examples) and there are signs that the process will accelerate in the nearest future.

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