



## GROWTH-PROMOTING SOCIAL SAFETY NETS

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Publicly funded, noncontributory transfer programs targeted to the poor and vulnerable have a long history. Free food distribution was a feature of Egypt in the time of the Pharaohs and of Rome during its Imperial age. England had a succession of "Poor Laws" dating from the 16th century that provided assistance to those unable to work, while Germany inaugurated components of the modern welfare state in the late 19th century. These programs, typically referred to as social safety nets or social protection programs, are now ubiquitous in developed countries and are becoming more common in developing countries. They are, however, controversial. While proponents of such programs see them as a means of ensuring that the benefits of economic growth are shared widely, critics see them as squandering scarce public resources and doing little to promote longer term development, while at the same time discouraging work and investment. Overlooked in this often polemical debate is the contribution that social safety nets can make in promoting economic growth. This instrumental dimension of social safety nets is the focus of this brief.

### **Growth-Promoting Social Safety Nets**

Social safety nets can take many forms: transfers of cash through welfare payments, child allowances, or pensions; in-kind transfers, such as food aid or school feeding programs; subsidies on goods purchased by the poor; unemployment insurance; and public works or workfare schemes. Recent innovations in social safety nets include both the means to improve targeting, such as proxy means testing, and the means to increase the impact of transfers on capital creation—for example, through conditional cash transfer (CCT) schemes and interventions that link recipients of cash or food payments to other government services and public works programs. Social protection programs are targeted toward the poor or those individuals who may become poor as a result of adverse shocks. This, together with their noncontributory dimension, distinguishes them from programs such as occupational pension schemes, which—while sharing certain

similarities with social protection programs—base eligibility and benefit levels on employment and contribution history, rather than, say, current poverty status.

The provision of safety nets is motivated by both equity and efficiency concerns. In part, safety net programs arise from a desire to assist the least well-off members of society. Additionally, such programs seek to offset credit and insurance market failures, which leave poor households unable to make investments that would raise their future incomes or protect them from adverse events. Thus, in addition to the intrinsic value of such transfers in creating a fairer society, social protection programs have an instrumental function in promoting economic growth. This works through five channels:

1. social safety nets help create individual, household, and community assets;
2. they help households protect assets when shocks occur;
3. by helping households cope with risk, they permit households to use their existing resources more effectively;
4. they facilitate structural reforms to the economy; and
5. by reducing inequality, they directly raise growth rates.

Each of these channels is discussed in turn below.

### ***Social Safety Nets and Asset Creation***

Reducing poverty requires raising the asset levels of the poor and increasing the returns to those assets. Achieving these objectives requires making investments, but doing so is hard when households have few resources of their own. In theory, such households could borrow money to finance these investments, but—as is now well understood—despite the impressive spread of microfinance institutions, many poor households lack access to credit, which would allow them to acquire assets, invest in their children's human capital, or enter profitable activities. Social protection provides liquidity to poor households, giving them

additional resources that can be used to make such investments. In Nicaragua, the CCT program Red de Protección Social raised school enrollments by nearly 22 percentage points, while Mexico's former Programa de Educación, Salud, y Alimentación (Progresa, now Oportunidades) significantly reduced stunting. A study of Oportunidades found that beneficiaries invest just over 10 percent of their transfers, and that this leads to sustained increases in per capita consumption in the following five years.

In addition to directing resources to the poor, certain forms of social protection can create assets of value to the local economy. Many developing countries have public works programs that rehabilitate roads, refurbish canal and irrigation facilities, or build structures—such as schools and health clinics—that are of value to the community and local economy. Such investments stimulate growth in the local economy. So too do the transfers themselves and the investments households make using these transfers. In addition, local communities are increasingly involved in decisionmaking surrounding the choice of assets to be built, the management of their construction, and the oversight of the finances being used. This not only increases the likelihood that the assets constructed are of particular value to the community, but also that communities build up social capital and governance capacity.

### ***Social Safety Nets and Asset Protection***

Risk and shocks—such as floods, droughts, price shocks, market collapses, and civil strife—are pervasive in developing countries. Such shocks can directly lead to a loss of livelihoods by destroying assets, as when a flood washes away a farmer's topsoil, or by reducing current returns to existing assets, as when a drought causes harvests to fail. They may also affect livelihoods indirectly, as when the demand for service providers, such as barbers or hairdressers, falls because their customers have become impoverished. In the absence of insurance, shocks force households to lower consumption, deplete savings, or both. The consequences can be far reaching. Farmers in Ethiopia who suffered livestock and other losses in the droughts of the 1980s found it difficult to recover and experienced considerably slower income growth in the decades that followed. Studies undertaken in countries as different as Bulgaria and China found similar results.

Shocks, even if temporary, can also reduce investment in human capital with long-lasting consequences. In Zimbabwe, children exposed to the civil war preceding independence and the droughts that occurred in the early 1980s were more likely to be stunted as preschoolers, had reduced stature by late adolescence, and completed less formal schooling. These shocks translate into a reduction in lifetime earnings

on the order of 14 percent. Similarly, children in rural Mexico have higher dropout rates when a parent loses a job and, once out, a much lower chance of returning the next semester.

### ***Social Safety Nets and Resource Allocation***

Even if shocks do not reduce asset holdings, the threat of shocks discourages innovation and risk taking. It is true that many households have developed ways of insuring themselves against risk, but these come with high opportunity costs. Studies undertaken in south India and Tanzania show that, because poor households deploy their assets more conservatively than wealthy households, their return on assets is 25–50 percent lower. Further, the threat of shocks can make households reluctant to access credit markets because they fear the consequences of an inability to repay. Others are simply unable to obtain credit because they are perceived to be at risk of default. Social safety nets, therefore, play two complementary roles in attacking the problem of risk and shocks. First, timely responses to shocks allow households to recover more quickly from these adverse events, thus reducing the likelihood that they have permanent consequences. Second, social protection programs that are reliably delivered and transparently operated provide a form of insurance that can encourage households to adopt new innovations.

### ***Social Safety Nets and Structural Policy Changes***

There are times when governments need to make significant policy reforms that, while necessary in order to improve economic efficiency and create the conditions for sustained growth, impose significant short-term costs on some households. Social safety nets can compensate households hurt by policy shifts and make policy reforms more politically palatable. Mexico introduced El Programa de Apoyos Directos al Campo (PROCAMPO) to mitigate the costs of adjusting to the North American Free Trade Agreement (NAFTA). The program had the added advantage of increasing production because the transfers helped relax credit and insurance constraints. Turkey introduced a similar direct income support in 2000 to facilitate reforms. So, programs that address the inherent stress of agricultural transformation and the reality that few policy changes are unambiguous sources of gains for all households may also improve efficiency in addition to equity.

### ***Social Safety Nets, Redistribution, and Growth***

Finally, by redistributing resources within an economy, social safety nets may make

economic growth more likely. While longstanding controversy surrounds the relationship between inequality and growth, the most recent evidence suggests that high levels of inequality are growth-retarding for at least two reasons. First, marked income or wealth inequalities create circumstances where political or institutional power is more likely to be captured by elites, who then make policy choices that generate rents to themselves rather than policies that encourage broader based growth. Second, high levels of inequality are often accompanied by low levels of social cohesion, which can reduce growth either because levels of trust are lower or because lowered social cohesion is often accompanied by high rates of crime.

### **Common Criticisms of Safety Nets**

There are two common criticisms of safety nets: first, that they create disincentive effects; and, second, that they are simply too costly, particularly for very poor countries. While these concerns need to be taken seriously, the preponderance of existing evidence casts serious doubt on both.

Disincentive effects arise for several reasons. Sometimes, it is argued that the receipt of public funds discourages work effort because beneficiaries favor increased amounts of leisure. Additionally, in cases where strict means testing is used, individuals may worry that if they work too much, they will lose access to their benefits. In addition to the effect on labor incentives, public safety net programs may change incentives for private individuals to assist family and friends; thus, social safety nets might crowd out informal safety nets such as private transfers.

Most studies, however, find that public transfers have modest effects on work effort. In some cases, this is not a bad thing; for example, some evidence suggests that CCT programs reduce child labor. The evidence on the crowding out of private transfers is more mixed. Some studies suggest that effects are substantial; for example, in South Africa, it is estimated that every rand transferred via a pension scheme reduces transfers from children living away from home by 0.25–0.3 rand. However, in other countries—such as China, Papua New Guinea, Vietnam, and Indonesia—no such crowding out is found. Evaluations of CCT programs in Mexico and countries in Central America also failed to find evidence of crowding out. While disincentive effects are worth keeping in mind—and program designers should ensure that social protection schemes do not inadvertently create disincentives—existing evidence does not suggest that they are pervasive or severe.

Perhaps the most potent criticism of safety nets focuses on their affordability in highly resource-constrained environments. Such concerns are often couched in terms of trade-offs between different forms of pro-poor expenditures. How can, it is asked, a country afford a safety net when residents in remote rural locations lack schools? This concern, however, exaggerates the costs of many well-targeted programs; frequently, social protection programs are less than 1 percent of gross national product, an amount that can often be financed by re-allocating unproductive expenditures that offer little tangible benefit for the poor. For example, Brazil is expanding its well-targeted CCT program, Bolsa Familia, to cover the bottom quintile of the population at a cost of 0.4 percent of gross domestic product (GDP). While this is a considerable amount, it falls in comparison to the contribution made to federal pension programs, which receive nearly 10 times this amount, at 3.7 percent of GDP, while transferring more than half the benefits to the richest quintile! This is not an isolated example. Other countries spend considerable amounts of money on regressive energy subsidies, which tend to take the form of industry subsidies, bank bailouts, and military expenditures. That said, in very low-income countries, there may be limited scope for re-allocating existing expenditures or increasing domestic tax efforts. In such cases, international aid may need to play a larger role in financing social protection programs. Here, care is needed in terms of the form of this financing. A subset of transfer programs is financed by food aid, which under some circumstances may create local market distortions.

### **Caveats and Conclusions**

Social safety nets are by no means sufficient to ensure pro-poor growth. Good governance, functional infrastructure, schools and health clinics, and so on are all important components of development strategies. Further, poorly designed or implemented social protection programs, or those with only token funding, are unlikely to meet the intrinsic or instrumental objectives described here. Much depends on correct design. All effective social safety nets have five key characteristics: (1) a clear objective; (2) a feasible means of identifying intended beneficiaries; (3) a means of transferring resources on a reliable basis; (4) ongoing monitoring of operations and rigorous evaluation of effectiveness; and (5) transparency in operation to encourage learning, minimize corruption, and ensure that beneficiaries and the wider population understand how the program functions.

Much has been learned about how to design and implement equitable and efficient safety nets with these characteristics. An important remaining challenge is the design of safety nets that address the long-term consequences of transitory shocks. This requires improving the identification of those affected by a transitory shock, devising flexible means of financing responses to these events, and developing mechanisms for scaling up and down quickly.

Safety net interventions can contribute to economic growth through their impact on asset creation, asset protection, resource allocation, structural policy change, and redistribution. Social safety net interventions, when well-designed and implemented, can complement

pro-poor investments and thus contribute to longer term poverty reduction in addition to their short-term direct impacts.

**For Further Reading:** H. Alderman, J. Hoddinott, and B. Kinsey, "Long Term Consequences of Early Childhood Malnutrition," *Oxford Economic Papers* (Vol. 58, 2006); D. Coady, M. Grosh, and J. Hoddinott, *The Targeting of Transfers in Developing Countries: Review of Experience and Lessons* (Washington, DC: World Bank and IFPRI); J. Das, Q. Do, and B. Özler, "Reassessing Conditional Cash Transfer Programs," *World Bank Research Observer* (Vol. 20, No. 1, 2005); M. Grosh, C. del Ninno, E. Tesliuc and A. Ouerghi, *From Protection to Promotion: The Design and Implementation of Effective Safety Nets* (Washington, DC: World Bank); E. Skoufias, *PROGRESA and its Impacts on the Welfare of Rural Households in Mexico*, IFPRI Research Report No. 139 (Washington, DC: IFPRI).

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