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How can Financing of Social Services be Pro-Poor?

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Summary

In the first part, a brief discussion of the interactive relationship (synergy) between income growth and social policy is presented. Our model of synergy leads to a set of pro-poor recommendations which explicitly integrate economic and social policies. Social services financing is a critical link between economic and social policies; however, the paper argues that social policies alone cannot be pro-poor; economic policies must be complementary and reinforce that objective. Recent good and bad experiences on financing social policy are presented from various countries and assessed in terms of how progressive and solidaristic they are. From this perspective, recent trends are not very encouraging. Since the inception of structural adjustment programs, there has been a push towards VATs (and other indirect taxes). Indirect taxes are not pro-poor sources of revenue for social polices. Nevertheless, not all reforms have had negative effects. In particular, within the last ten years or so, there has been a growing recognition among policy-makers on the detrimental effects of user fees. Countries should be encouraged to implement direct progressive taxes. The United Nations and the IFIs should take a leading role in terms of capacity building in this area. Donors should help foot the bill in terms of training and the required infrastructure to ensure compliance with these taxes.

Introduction

The mainstream view of development posits that if economic growth is maximised, poverty will be reduced, and increases in welfare will ensue (in a more or less automatic fashion). Thus, much policy-making occurs under a leader/follower hierarchy model, where macro-economic policy is determined first, while social policy is derivative and left to address the social consequences of economic policies (Atkinson, 1999). This separation of the 'economic' from the 'social' discourse is inherent to the Washington consensus and the Neoclassical theory which underpins it. Moreover, under this view, only certain policies ensure economic growth. In contrast, social policy can and should be understood as "collective interventions in the economy to influence the access to and the incidence of adequate and secure livelihoods and income" (Mkandawire, 2004, p.1).

In the first part of this paper (section 1), a brief discussion of the interactive relationship (synergy) between income growth and social policy is presented. Our model of synergy leads to a set of pro-poor policy recommendations which explicitly integrate economic and social policies and which are associated in the economics literature with different heterodox approaches (Post-Keynesian, Evolutionary, Structuralism, and Transformational Growth[1]).

The core of the paper (sections 2 to 4) deals with issues of social services financing, presenting recent good and bad experiences from various countries and contexts and assessing how progressive and solidaristic these reforms have been. Section 2 examines the scope for intra- and inter-sectoral restructuring of expenditures within health and education. Section 3 examines the prospects for mobilizing additional revenues from taxation from domestic sources. Section 4 deals with recent trends in public-private partnerships and section 5 discusses some important issues about the relationship between the individual and the state to be considered when discussing public financing of social services and pro-poor policies. Section 6 concludes the paper by highlighting that social and economic policies cannot be divorced. Taxation should be assessed from the point if view of whether it contributes to a pro-poor policy context. Unfortunately, since the inception of structural adjustment programs most reforms have not been pro-poor, with the exception of the elimination of user fees.

[1] See, among others, Taylor (2006), Nell (1998a), and Chang and Grabel (2004).

1. The synergy between Social Development, Poverty reduction, Economic Growth

1a) Preliminaries

In the positive experience of recently industrialised countries or of high-achieving developing countries, we are struck by the difficulty of establishing causality relationships between human development and economic growth. For example, despite widespread literacy within a population, many countries have not achieved rapid growth, although education is a major determinant of such economic growth[2]. There are also examples of countries with relatively rapid economic growth but persistent income-poverty. Indeed, the relationship between economic growth, income-poverty, and health/education development is a complex one. A framework to describe these linkages is presented below[3].

The lingering question remains: if there are no sufficient or necessary conditions linking these elements, are they unrelated? The answer is, yes they are related, but in a complex way. Although no particular element is necessary or sufficient for the advancement of the other, they help each other. Thus, for instance, the effectiveness of industrial policy in inducing economy-wide productivity growth or non-agricultural employment in rural areas, will be enhanced by the presence of a healthy/educated population, in turn resulting in higher rates of income growth.[4]

1b) Theoretical framework

A synergy or feedback loop can be succinctly expressed as the enhanced impact a change in an independent variable has on the growth rate of a dependent variable, given the presence of a third variable (Haken, 1979)[5]. This leads to several important, and often

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[2] The answer is obvious too: because other growth-oriented policies (such as technological change to induce productivity increase, macroeconomic stability,) are not present.

[3] Our framework could be considered a "magnifying lens" view of the Transformational Growth matrices developed in Nell (2005), whereby we introduce less elements (e.g. we do not include youth socialization), but we attempt to provide more detail to the interactions we do explore.

[4] Thus, no single element can be specified as the main cause (or "development magic bullet") for success in all areas. Pritchett (2003), Easterly (2001) and Levine and Radelet (1992) discuss various shortcomings of econometric estimates that attempt (and fail) to establish these relationships.

[5] It should be noted, in order to distinguish from the static influence of multiple factors in traditional economic analysis (e.g. Cobb Douglas production functions), that the synergies take place in terms of rates of change, not levels of activity.

overlooked, inter-related effects in terms of policy. The impact of a policy (e.g. redistribution to directly reduce poverty) on another variable (say economic growth) crucially depends on the level and rate of change of a third variable (e.g. health and educational status). In other words, economic growth will be faster and longer-lasting if (income) poverty is reduced simultaneously through direct policies and the health and educational status of the population is higher and increasing[6]. What we have in mind can be expressed in a set of three relationships (income growth, income poverty reduction, and social development), the determinants of each of which are discussed below.

GNP per capita growth = f_1 *(macroeconomic policies, social policy, income poverty reduction, technical/structural change, reproductive labor) (1)*

GNP per capita growth is not chosen by governments, but is the result of the combination of public policies and private decisions. GNP per capita growth is influenced by the provision of social services, i.e. social policy and reproductive labor, This does not imply that they are the same or that one is a perfect substitute of the other one. On the contrary, when the government does not provide the services through social policy and women have to provide care, it is a time-burden tax on women. The pace of poverty reduction, the nature of macro-economic policies, and, most importantly in the medium to long run, technological change (i.e. the introduction of value adding activities and productivity increases through technical/structural change) also affect economic growth.

Low unemployment and high wages reduce poverty, leading to higher levels of consumption, internal demand and economic growth.[7] Stable prices and low interest rates also contribute to a favourable context in which firms would want to invest and create

[6] A widely recognized simple example, and one often mentioned even within the Washington Consensus literature, is that economic growth will be more successful in reducing income-poverty, i.e. the elasticity of poverty-reduction will be higher, when human capital is more equitably distributed. We do not deny this. We only stress that this is only one of the many interactions among various interventions. A classic application in economics is Goodwin (1967).

[7] "The liberal reward of labour, therefore, as it is the necessary effect, so it is the natural symptom of increasing national wealth. The scanty maintenance of the labouring poor, on the other hand, is the natural symptom that things are at a stand" Adam Smith (1776, Book I, Chapter 8).

well-paying jobs. However, this does not mean that macroeconomic stability per se results in economic growth, as evidenced by the standard error of the regressions that try, but fail, to establish this point[8]. Nor does this imply that a privately-led boom will not result in imbalances. Here we want to stress that innovations are introduced through investment - which is financed by profits or by inflows from abroad. The latter may be more volatile than the former and both are influenced by macroeconomic policy[9].

In order to understand the engine of growth, i.e. technological change, (Abramovitz, 1989; Chakravarty, 1982; Schumpeter, 1934; Solow 1997), a model such as the evolutionary one, rather than one involving firms with absolute knowledge concerning static production functions, is needed. Such a model would stress that both inventing and adapting new technologies is a process of discovery characterised by uncertainty, rather than by probabilistic risk (Nelson and Winter, 1982). In this case, markets are not efficient and have no tendency to reach equilibrium, as they tend to change (Anderson, Arrow and Pines, 1988; Lesourne and Orléan, 1998, Pack 1992, Verspagen, 1993, Nell 1992 and 1998a and b). This different theoretical perspective leads to alternative policy recommendations.

For instance, if markets are in constant flux as firms try to alter those constraints through innovation, then the very notion that taxes or import restrictions introduce distortions lacks foundation. Taxes do, however, play another (apart from generating revenue) important role that is usually unnoticed. Taxes affect the distribution of income, with concomitant effects on income poverty, as we see next.[10]

We now turn to the determinants of income poverty reduction.

Income poverty incidence reduction = f_2 (GNP per capita growth, social policy, asset re-distribution policies, reproductive labor) *(2)*

As with economic growth, the primary income distribution is not in the hands of governments to decide, but emerges from market results and relative bargaining power

[8] See, for instance, Bleaney (1996), Hausmann et al (2005) and Sirimaneetham, V and J. Temple (2006)

[9] Further, the focus on freeing up financial markets in the Washington Consensus may have had the adverse effect of contributing to macro-economic instability by weakening the financial sector (UNCTAD, 1998, Grabel 2003).

[10] The role of environmental policies on economic growth is discussed later in order to avoid repetition.

between the owners of factors of production. The distribution of income, in turn, affects the incidence of income-poverty. Nevertheless, both through regulation and overall management of macroeconomic conditions (captured in the GNP per capita growth variable), the government can affect income distribution.[11]

Moreover, the distribution of assets can be altered (e.g. land-reform, titling, distribution of shares) which in turn will affect the primary income distribution. It has been argued that the single most important economic factor affecting women is the gender gap in command over property. In rural South Asia, the most significant form of property is arable land, which is a critical determinant of economic well being, social status, and empowerment. However, few women own land and fewer control it (Agarwal, 1994). Women's inheritance claims regarding land are often opposed because they would decrease agricultural output by reducing farm size and increasing land fragmentation. In fact, existing evidence shows that small-sized farms in South Asia continue to have a higher productivity per sown acre than large-sized ones. Evidence from sub-Saharan Africa has also argued that one of the factors constraining growth and poverty reduction is the gender inequality regarding access to and control of a diverse range of assets (World Bank, 1999).

Gender discrimination not only affects ownership of physical assets, it also influences the allocation and pay rates of labor. This explains the need to include reproductive labor in the equation. The negative impact in terms of poverty reduction opportunities can be seen, for instance, in wage differentials by gender for the same job, allocation of time in care (which reduces the available time for earning related activities), and the contribution to production for self-consumption by women rather than for the market.[12]

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