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**Social security, social impact and economic performance:  
A farewell to three famous myths**

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<sup>1</sup> This paper draws extensively on the paper “Social protection as a productive factor” that the Social Security Department presented to the ILO’s Governing Body in November 2005.



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## 1. Introduction: Social protection and its primary objective

Social protection systems consist of the set of (a) all transfers in a society that seeks to provide income security and prevent and alleviate poverty; (b) all measures that guarantee access to health and social services; (c) all measures that protect workers' income, health and well-being. Social protection thus seeks to free people from social insecurity and consequential existential fear and is thus inevitably an income redistributive system. If designed, managed and administered well, social protection systems generally achieve that objective.

Social security is a human right (article 22 of the Universal Declaration of Human Rights) and its roll-out to as many people as possible is a part of the ILO's mandate.<sup>2</sup> The need to extend social security had last been confirmed by the International Labour Conference in 2001.

National social security systems – world wide - achieve demonstrable success in reducing poverty (see section 2). What remains to be explored is whether these results are obtained through incurring high opportunity cost in terms of reduced economic growth which would inevitably be associated with long-term welfare losses of a society - provided the benefits of growth are equitably distributed. This paper tries to establish the state of the art on what we know – or seem to know – about the economic effects of social protection.

The paper first revisits the standard economic arguments on the potential inter-relationship between social security and economic performance, then evaluates some of the statistical evidence and finally applies some simple logic to refute three of the major myths with regard to the relationship between social protection and economic performance. These are: (1) at each stage of development societies can only afford a certain level of social expenditure (the affordability myth); (2) economic growth will automatically reduce poverty (the trickle-down myth); (3) there is a trade-off between social expenditure and economic efficiency (the trade-off myth).

## 2. Social security and its social outcomes

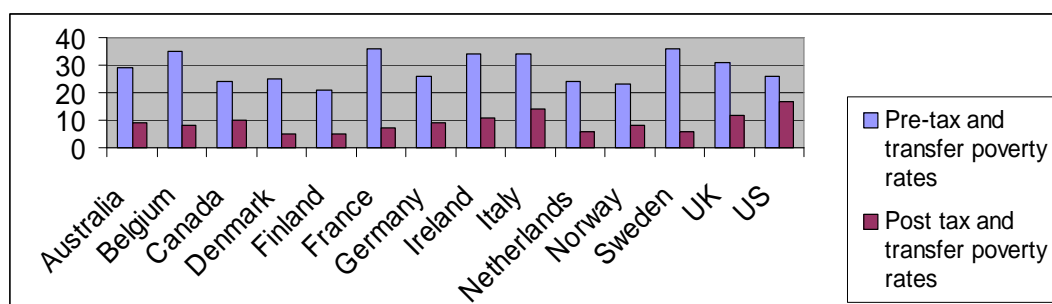
There is clear evidence from Europe and OECD countries that social transfers successfully reduce poverty and social insecurity.<sup>3</sup> Figure 1, below, shows the net estimated effect of public transfers and taxes on poverty rates (as measured by the poverty head count index, which is perhaps the clearest indicator of income inequality) in OECD countries, i.e. in countries with a fairly extensive social transfer system and well-developed tax systems. The effects are nothing less than dramatic. The reduction of the pre-tax and transfer poverty rates ranges from a minimum of about 10 percentage-points, estimated in the US, to a high of around 30 percentage-points, found for Sweden.

Figure 1 describes the effects of high spending social protection countries vs. low spending countries on national poverty lines. Higher than average social spending is demonstrably correlated with reductions in national poverty headcount levels.

<sup>2</sup> See Declaration of Philadelphia - article III (f), including clauses (d) and (f), leads to a broad definition of social protection.

<sup>3</sup> Cichon et al. (ILO): Financing Social Protection, Geneva, 2004, pp. 37-41.

**Figure 1. Pre-tax and transfer vs. post-tax and transfer poverty rates in selected OECD countries in the middle of the 1990s (referring to total populations)**



Source: OECD.

It is not possible to draw such clear-cut conclusions in relation to developing countries, since overall volumes of social transfers are comparatively small. However, some basic social protection transfers, such as basic non-contributory pension schemes have proven to be powerful in the fight against poverty. A variety of countries have introduced universal pension schemes in recent years, and while they have mostly provided benefits at modest levels, their effects by way of poverty reducing effects for whole families have been very positive. Benefits are provided overtly for the old and disabled, but in practice benefits provided for individuals – whose status in their families is often significantly enhanced through their receipt of a cash income – effectively support whole families. Redistribution of cash income within the household, means that more families than hitherto are able to finance school fees, medicines, etc.<sup>4</sup> Strong evidence of positive experience comes from countries as diverse as Brazil, Mauritius, Namibia, Nepal and South Africa. The ILO's International Financial and Actuarial Service has calculated that the provision of such a basic package of social transfers in most countries would cost between 1 and 2 per cent of GDP, which would equate roughly to between 5 and 10 per cent of national budgets. Implementing such a package in many countries could represent a rapid first step in a broader attack on the kind of deep-rooted and chronic poverty often found in "pockets" within countries.

Social transfers also have a marked impact on income equality, which can be interpreted as an indicator of social coherence. Evidence from the Luxembourg Income Study<sup>5</sup> of the mid-1990s (thus before the recent wave of reforms) shows that the combined tax and transfer systems in OECD countries reduce income inequality by between 40 per cent and 50 per cent in countries including Belgium, France, Germany and Sweden, and by between 20 per cent and 30 per cent in countries such as Australia, Canada, the United Kingdom and the United States. Prominent observers of the emerging inequality in Europe and OECD since the mid-1990s, including Smeeding (2002)<sup>6</sup> and Atkinson (2002),<sup>7</sup> attribute increasing inequality within societies, as measured by increasing Gini coefficients, to changes in governments' tax and transfer policies. Atkinson (2002) concludes that, when

<sup>4</sup> Age and Security: How social pensions can deliver effective aid to poor older people and their families. HelpAge International, London, 2004.

<sup>5</sup> See Ruiz-Rueta, J. et al: Earnings inequality, unemployment and income distribution in the OECD, LIS working paper No. 214, New York, 1999.

<sup>6</sup> Smeeding, T.M.: Globalization, inequality and the rich countries of the G-20: Evidence from the Luxembourg Income Study (LIS), Sydney, May, 2002.

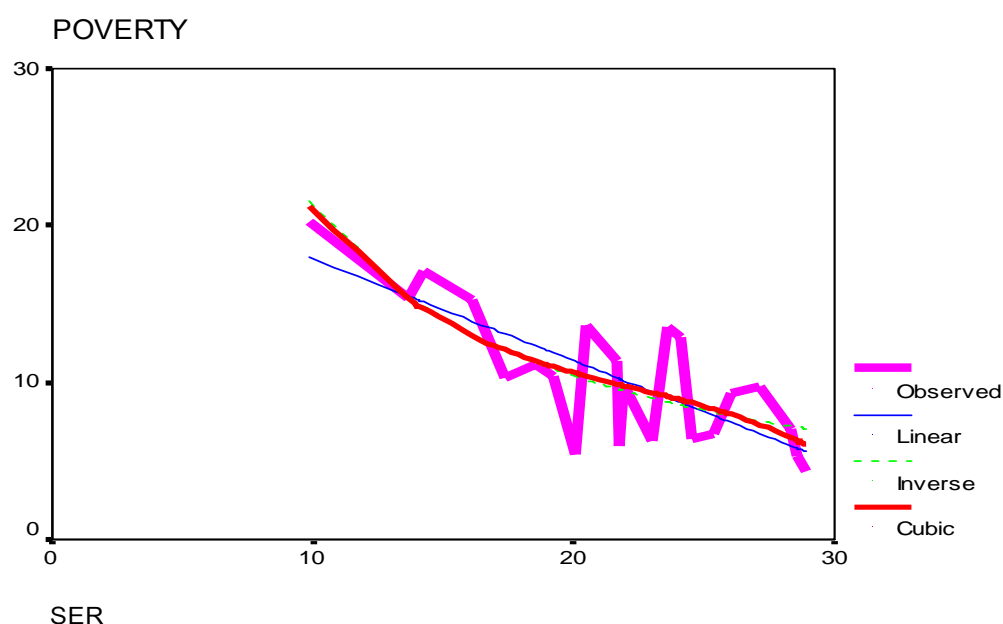
<sup>7</sup> Atkinson, A.B.: Income inequality and the welfare state in a global era. New York, 2002.

analysing the impact of globalization and public policy on changing income equality, “... we must not lose sight of policy. Changes in tax and transfer policy have played a major role in the increasing inequality in a number of countries. To a considerable extent the developments of inequality in disposable incomes – what matters to our citizens – lies in our own hands.”

The key question that remains to be answered in the context of this paper is whether these positive effects may actually lead to too high opportunity cost in terms of economic performance. In other words, should a country not invest more in pro-growth policies since that would reduce poverty to a larger extent in the long-run than social transfers would? The latter is the famous “trickle-down” or “the tide will rise all boats” effect. There is an intellectual difficult problem here. Even if economic growth were to reduce poverty in the long-run, how do we “discount” that reduction of poverty to compare it to the immediate effects that social transfers apparently have on poverty today? That is obviously a difficult question to answer. But we may get around it, by looking at some statistical evidence.

Figure 2 shows the relationship between national poverty rates in 22 OECD countries and the national social expenditure ratio (SER) (i.e. total public social expenditure over GDP). Figure 3 correlates national per capita GDP levels in purchasing power parities and the same poverty rates. Poverty rates are here defined in line with OECD statistics as 50 per cent of the median national incomes. All data used are coming from OECD statistical data bases. The figures also relay the key statistical results of the regression. Three different types of regressions are tested to broaden the validity of the exercise, i.e. curvilinear regressions using linear, cubic and inverse functions.

**Figure 2. Interrelation between poverty rates and total social expenditure ratios in selected OECD countries, 2000**



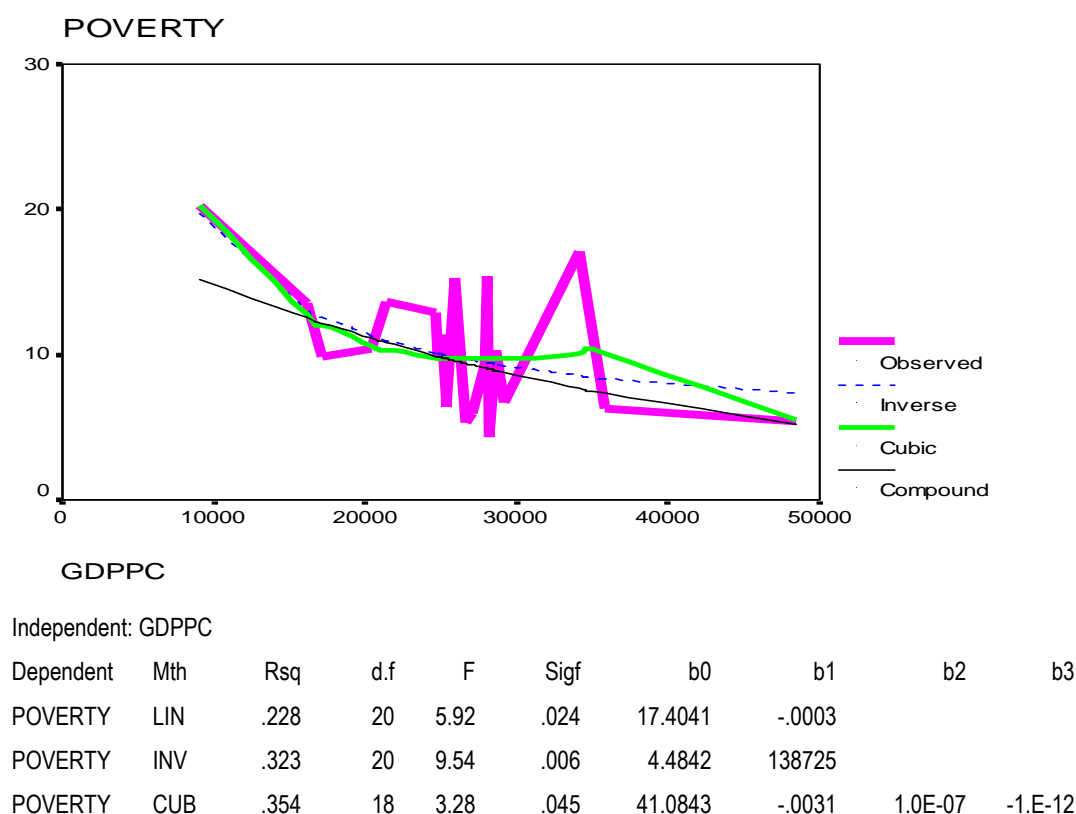
Independent: SER

Dependent	Model	Rsq	d.f.	F	Sigf	b0	b1	b2	b3
POVERTY	LIN	.607	20	30.91	.000	24.3699	-.6497		
POVERTY	INV	.636	20	34.88	.000	-.4459	217.165		
POVERTY	CUB	.652	18	11.22	.000	56.0540	-5.4098	2235	-.0033

Poverty drops clearly in association with increasing social expenditure and increasing GDP levels. And so it should. However, interestingly, in the R square, the measure of association between GDP per capita and poverty lines is only in the order of 0.35 in the best case and thus 53 per cent lower than in the “best” regression line between poverty rates and social expenditure ratios. Both exercises show high statistical significance levels. This means that poverty reduction is much more associated with national social expenditure ratios than with levels of GDP. Without entering into the causality debate, one can conclude that increasing GDP levels can and do in many cases reduce poverty. That effect, however, is not certain. It is much more probable that increasing levels of social expenditure will reduce poverty. So the apparent choice between transfer-based poverty reduction now and growth-based poverty reduction may be a false alternative. Without redistributive mechanisms such as social security transfers, economic growth may not affect poverty noticeably. Since it takes decades to build functioning social transfer systems, waiting with their introduction till high levels of GDP have arrived is not a realistic option. “Trickle-down” effects do not occur automatically.

Figure 3 combines the above exercises in one single figure. It shows the relationship between poverty rates, social spending and levels of GDP for a much wider data set as the OECD countries. It shows that at each level of GDP per capita in purchasing power parities countries with higher than average social security spending have lower poverty rates than countries with lower than average social security spending. Interestingly, the distance between the two lines remains almost constant for major ranges of GDP per capita. If the “trickle-down” hypothesis were true, the distance between the curves should narrow towards the higher ranges of GDP per capita and the low spenders should improve their relative poverty performance. This does not seem to be the case. More detailed studies are necessary to explore the effect in more detail, but what we can say now is that the acceleration of poverty reaction with increasing GDP per capita in the low spending country group compared to the high spending groups does not seem to take place. Another question mark behind the trickle-down effect...

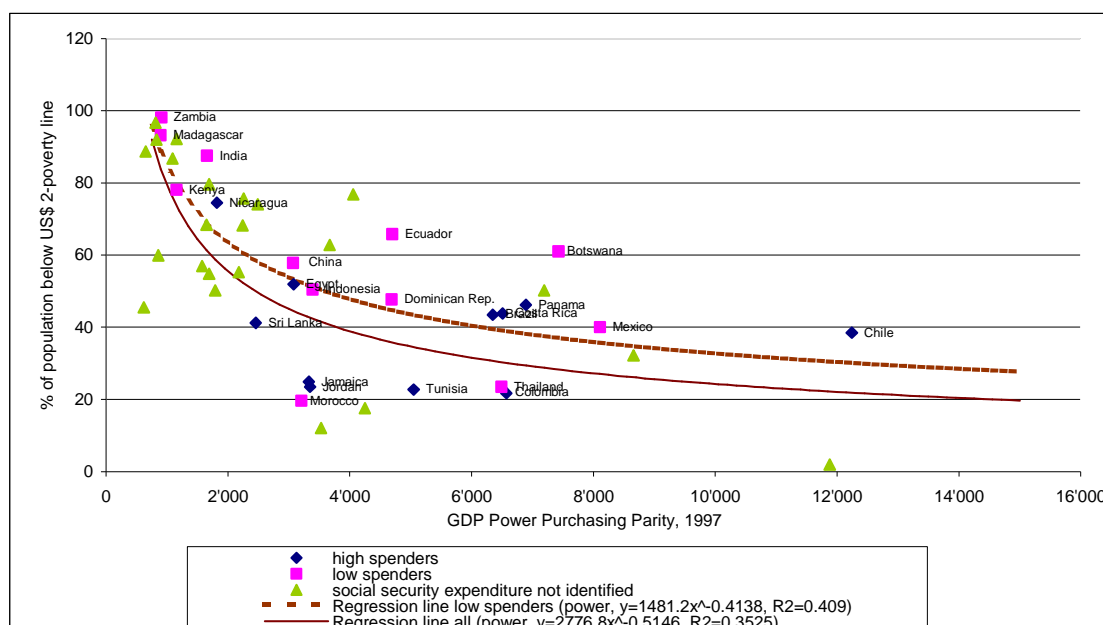
**Figure 3. Interrelation between per capita GDP and poverty rates in selected countries, 2000**





The graph also shows that at each level of per capita, GDP countries have a choice as to how extensively they want to combat poverty through redistributive transfers or not. Countries seem to be able to afford a wide range of different levels of social spending at the same level of GDP per capita - a theme to which we will revert in later sections.

**Figure 4. Percentage of population below US\$2 – poverty line versus GDP PPP per capita (1997); countries grouped according to high and low spending on social security (exponential regression); transition countries excluded**



Thus, social transfers are associated with reductions of poverty, much more directly as high levels of GDP. This leaves us with one critical question: Could it be that social expenditure at certain stages of development compresses economic growth so much that the “loose” anti-poverty effect of a potentially higher GDP would be bigger than the one that can be achieved by social expenditure at the existing level of GDP. In other words, could Sweden, for example, without its extensive welfare state have achieved such a high level of GDP that the resulting level of poverty at that high level would be lower than the level that it achieves today? Or again, in other words, what would be the counterfactual anti-poverty effect of non-welfare states compared to welfare states. The answer can – if it exists - only come from an assessment of the effect of social expenditure on economic growth. Before we try to analyse the evidence that we have we have to recapitulate an inconclusive theoretical academic debate.

### 3. The academic debate about social protection as an input to economic growth

National social protection systems and their perceived effects on economic performance have been subject to intense policy debates in many countries during the last decades. On the one hand, experts<sup>8</sup> (notably those working in the international financial institutions (IFIs)) claim that social systems redistributing up to 30 per cent countries' GDPs – and,

<sup>8</sup> See, *inter alia*, IMF: World economic outlook, April, 2003, Chapter IV.

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thus, since considered too high<sup>9</sup> – are no longer affordable. Social protection expenditure is seen as an impediment to growth creating negative short- and long-term growth effects.

Potentially conduits of detrimental economic effects of social protection systems are:

- a) Financing transfers exclusively through taxing labour can have negative labour market effects if wage structures are rigid.
- b) Financing or subsidizing social protection benefits out of general revenues can contribute to the deterioration of the government budget deficit, increase domestic interest rates and hence reduce private investment and growth. Such financing of transfers might also cause opportunity cost in terms of reduced public investments.
- c) Wrong incentives set by income protection mechanisms in the presence of, e.g., unemployment and early retirement schemes, can trigger withdrawals of potentially productive employment from the labour force.
- d) Some national social protection systems cause administrative costs that produce fiscal waste and hence high economic opportunity cost as required contributions/taxes could, alternatively, be used for financing production.

Proponents of this line of argument base their reasoning usually on standard growth theory. Their advantage in reasoning is that they dispose of a “canonical”, mathematically formulated set of models, whose results overwhelmingly point in the same direction.<sup>10</sup>

On the other hand, potential conduits for positive effects of social protection systems are:

- a) Social security systems create the social peace that is a necessary condition for the long-term viability of all investments.
- b) Reliable access to social transfers reduces existential angst through providing at least a minimum level of income security, reduces the need to resort to illegal methods of earnings in income, reduces the potential for social unrest and hence creates social peace, which is a prerequisite for long-term profitable investments.
- c) Reliable access to unemployment and other social transfer benefits facilitates the adjustment of labour forces to structural changes of economies.
- d) Substantial expenditure on health care, safety and health, and prevention and alleviation of HIV/AIDS can increase labour productivity.
- e) Income smoothing through social transfer stabilizes consumption and hence avoids abrupt contraction of domestic demand in times of recession.
- f) National pension savings have or can become a major source of domestic finance for investments and thus may play an important role in the developing or restructuring of economies.

<sup>9</sup> Although it is not always clear when social expenditure is considered “too high”.

<sup>10</sup> The *anti-social protection position* is equally covered by the main stream proponents of “neo-historic” economic growth theory. However, they do not (yet) dispose of a similar set of mathematically formulated and generally accepted growth models, which would help to support their reasoning.

- g) Social protection and the financing of social services through social protection itself generates a substantial proportion of total employment in modern service-based economies.
- h) Social transfer systems can help to redistribute some of the proceeds of economic growth (inter alia, created through globalization) to the most vulnerable persons in societies and can, thus, help to create a broader acceptance of globalization.
- i) Collective social security systems that protect people against partial or total loss of income would have a moderating effect on labour costs as people would not have to build up huge personal contingency reserves financed from wages and other incomes.

It should be added that countries where diversion is low but focus on production is strong, i.e. the large European welfare states, have (meanwhile) made their social protection systems operate at enormously low administration costs, which are usually much lower than in many private insurance schemes and hence are more efficient than those in delivering social security.

Despite the fact that, at present knowledge, the pros and cons of the impact of social protection on economic growth seem to be fairly balanced, in political and economic discussions it is those claiming that well functioning social protection systems are an indispensable prerequisite for growth in open market economies, which are – analytically – in the weakest analytical position.<sup>11</sup> Social protection as an input factor to economic growth – this hypothesis plays close to no role in the academic syllabus in economics of universities around the world. One of the reasons for this “state of the art” in growth economics is the fact that the proponents of the argument – that the level and quality of social protection might significantly contribute to explaining differences in long-term growth rates and, thus, of countries’ income levels – have, thus far, not undertaken efforts to formalize their argument and consequentially face difficulties to compete successfully with ubiquitous standard explanations. Here, we are forced to look at scarce evidence to approach an answer.

## 4. Empirical evidence

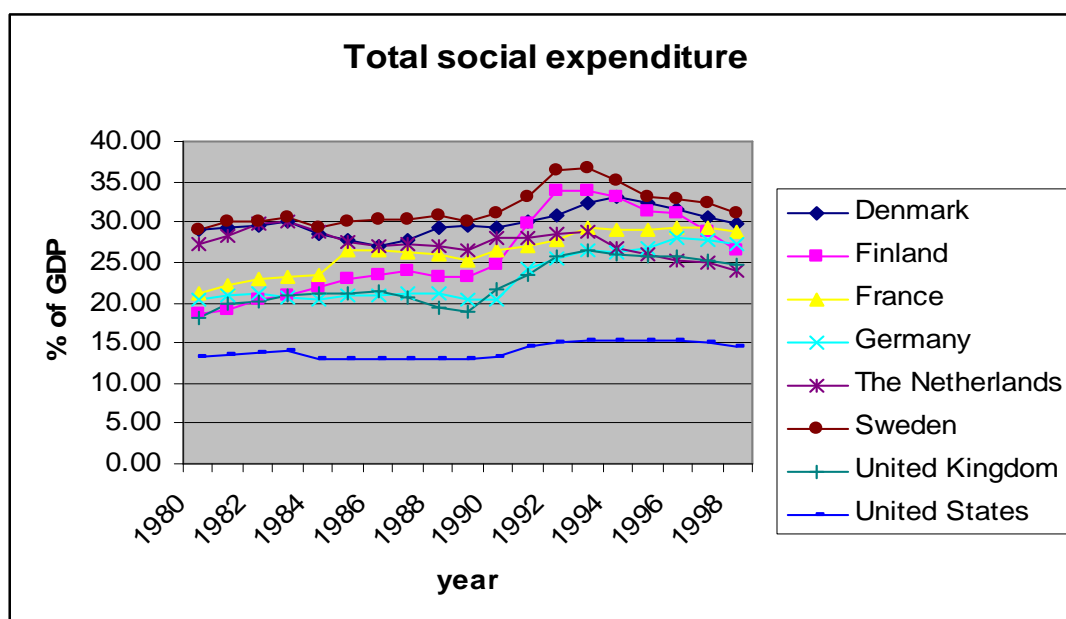
### 4.1. Historical evidence

Since about the middle of the 1970s, i.e. after the first oil price crisis, countries with well-established social protection systems entered a period of *welfare state containment*. Major welfare states like Austria, France, Germany, the Netherlands and others, broadly kept their social expenditure shares in GDP at the levels reached in the mid-1970s. After the fall of the iron curtain, these ratios transitorily peaked at high levels in those countries economically most affected by the resulting changes in multilateral trade relations and/or by other factors (e.g. in Germany the unification). Meanwhile all countries are back to their “normal” levels. (Figure 5) In fact, all containment measures reflect the *new paradigm of economic policy*, increasingly dominating political and socio-economic discussions and analyses since at least around 20 to 25 years, which claims that low European growth rates are mainly a result of too high and wrongly designed (badly structured) social protection provisions. If that were true, one would expect further reductions of the social expenditure ratios in future. In any case, such moves would have to be implemented against counteracting social needs, like increased unemployment, increasing health care costs, changing family structures or increasing old-age dependency rates, which all increase

<sup>11</sup> See, *inter alia*, ILO (2001): pp. 11-12.

societal insecurity in the industrialized countries. Thus far, what can be observed is that social expenditure in the OECD (measured in per cent of GDP) has stabilized at long-term levels, which equally applies to lower and to higher growth countries.

**Figure 5. Development of social expenditure in per cent of GDP, selected OECD countries**



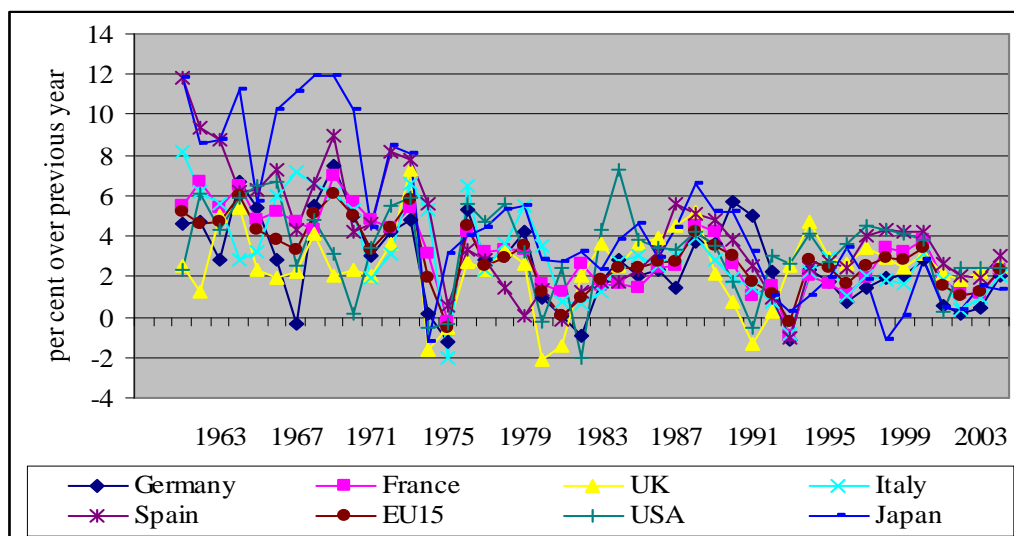
Source: ILO (2004).

Most obviously, contrary to mainstream expectations, this policy has not led to higher economic growth (Figure 5). Firstly, it has to be observed that economic growth rates have come down to moderate levels since the mid-1970s. It is since then that growth rates hover around a quite stable 2 per cent trend. While ranking of countries' growth performance changes over time, figure 5 clearly indicates that the industrialized countries – economically – are highly interdependent in their development. The further, slight, decline of rates since the early 1990s must, most obviously, be due to other effects than social spending, which was contained since the mid-1970s.

In comparing the dominating shapes of figures 4 and 5, one can already conclude that there is little correlation between economic growth rates and the share in GDP of social protection spending. Obviously, governments of major countries have over around the past 30 years continuously taken measures to maintain relative social protection spending at country-specific *constant* levels,<sup>12</sup> while, over the same time, GDP growth rates were declining trend-wise. Whether a reversal of GDP growth rates up to higher average levels will take place is an open question. However, it seems obvious that such a reversal will not likely be triggered through a stabilization of social spending.

<sup>12</sup> There are, of course, exceptions to this observation. Greece, for example, extended its social spending substantially over a period of about 20 years while Ireland significantly reduced its spending share in GDP over the recent past.

**Figure 6. Growth rates of GDP in major industrialized countries / regions**

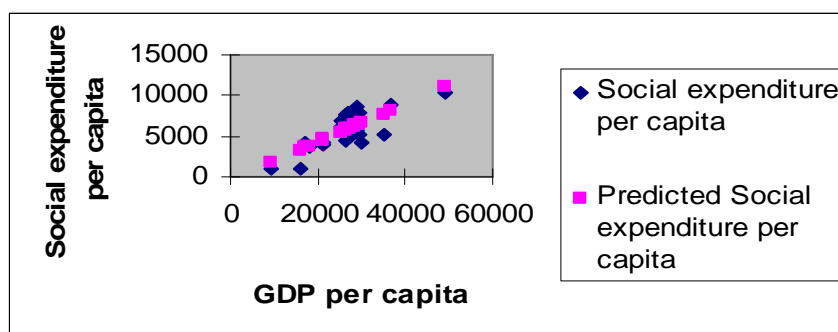


Source: Ministry of Health and Social Security, Berlin; EUROSTAT, Luxembourg.

#### **4.2. The statistical relationship between economic performance and social spending**

The following figure plots the relationship between the GDP per capita and public social expenditure per capita in purchasing power parities in 25 long-standing OECD countries. At first sight there is a positive relationship between these two variables and the R square indicating the fit of the regression curve is sufficiently high (0.62) for relatively crude analysis.

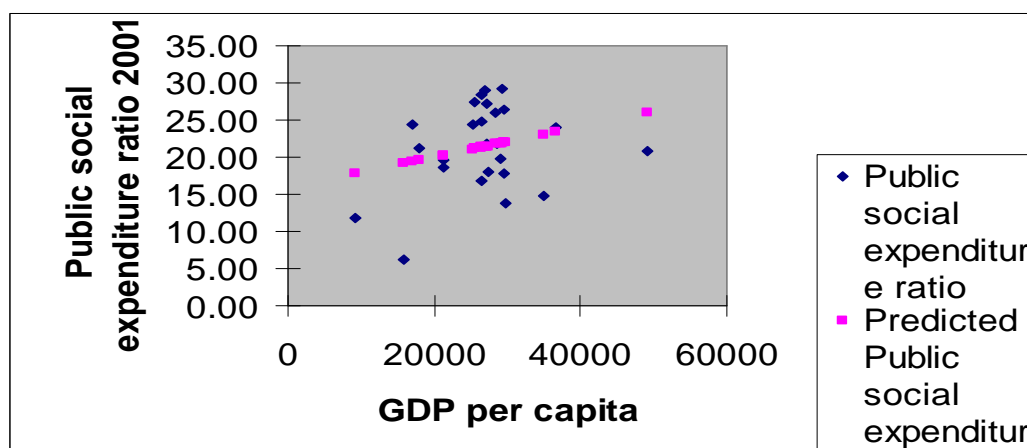
**Figure 7. Correlation between GDP and public social expenditure per capita in PPP, OECD, 2001**



However, the variables GDP per capita and social expenditure per capita have too many common determinants to provide a meaningful correlation. Social expenditure consists to a large extent of the cost of services and income replacing cash transfers. The absolute levels of both variables in the individual countries have direct links to per capita incomes and hence GDP per capita. To be more meaningful one should analyse the relationship between GDP and a variable that describes not only the absolute level of social expenditure but also incorporates aspects of discretionary national decision-making. The variable used here is the social expenditure ratio SER (i.e. as said before social expenditure expressed as a percentage of GDP).

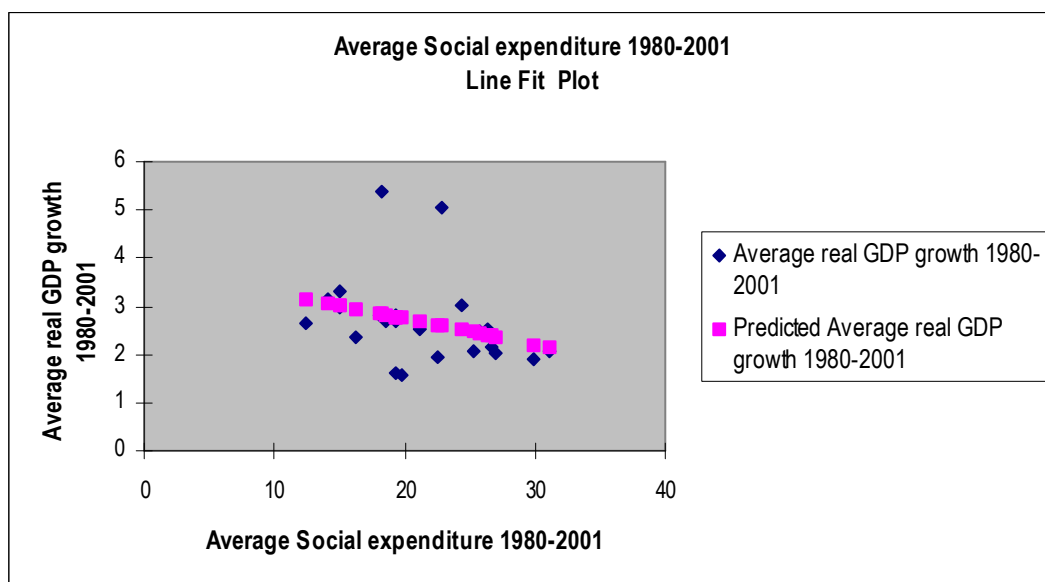
The statistical analysis of long-term growth rates in the OECD shows that the correlation between growth performance and the share of GDP that is allocated to social expenditure is weak. Figure 8 co-relates GDP per capita in purchasing power parities and the social expenditure ratio in 22 long-standing OECD countries in 2001. The R square is extremely small.

**Figure 8. Correlation between GDP per capita and (PPP) public social expenditure as a share of GDP (public social expenditure ratio)**



The following graph maps the average growth rates in the same countries between 1980 and 2001 with the average shares of social expenditure of GDP during the same period. While the regression shows a slightly negative slope, the R Square is also very low (i.e. 0.09). Limiting the period to the decade 1991 to 2001 only marginally changes the picture.

**Figure 9. Average social expenditure vs. long-term economic growth**



The figures confirm the earlier observation that there is virtually no direct relationship between the per capita GDP or the rate of growth and the level of the social expenditure ratio. Sweden and the UK, for example, have a similar level of GDP per capita but a more than 7 percentage-points difference in the social expenditure ratio. In both countries, social expenditure is largely of a public nature. Thus, the difference between the composition of total social expenditure between public and private expenditure does not affect the comparability.

Similarly, Ireland and Luxembourg, for example, have similar long-term growth rates, while the average social expenditure ratio in Ireland is 4 percentage-points lower than in Luxembourg. Italy, on the other hand, has a similar long-term social expenditure ratio like Luxembourg but its long-term growth rate is only 40 per cent of that of Luxembourg. The GDP growth performance is similar to that of Norway while it has only 40 per cent of the social expenditure ratio.

The above observations lead to one conclusion. Firstly, aggregate social expenditure figures do not explain a large part of national economic performance and do not seem to have a significant impact economic growth. Obviously, national policies and social security system designs can lead to a wide range of different levels of social expenditure at each level of GDP.

On further reflection, one might argue that levels of GDP per capita are determined by a variety of other factors that are clearly not predominantly influenced by the average level of the social expenditure ratio, such as the demographic structure consequential national levels of demographic dependency between actives and in-actives in a society, the nature of the national physical and human “capital stock”, etc. the average number of hours worked per worker, etc.

Social security provisions on the other hand might directly influence the level of employment by providing incentives or disincentives for labour market participation. When correlating social expenditure ratios and employment levels, we face a chicken and egg problem. On the one hand, high levels of unemployment lead to high transfer expenditure, while on the other hand, the availability of transfers may lead to high withdrawal rates. However, a regression analysis of the SERs and the employment-to-population ratios of the age group 15-64 for OECD countries show virtually no association between the two and the influence on the SER on employment levels is statistically not very significant.<sup>13</sup>

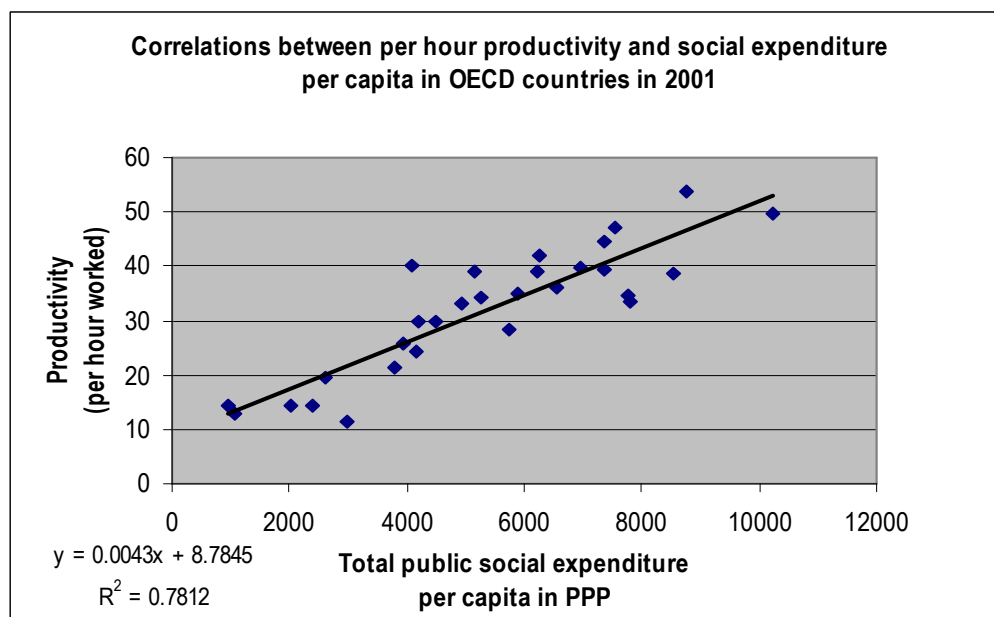
In order to exclude all these - partially contradictory effects - we have analysed the effects of social expenditure on hourly productivity. This analysis shows that in the OECD region there is a strong positive correlation between social expenditure (per capita of the population) and labour productivity (GDP per hour worked).

<sup>13</sup> The results of the regression analysis are as follows:

Independent: SER 2001

Dependent	Model	Rsq	d.f.	F	Sigf	b0	b1	b2	b3
ER2001	LIN	.043	27	1.20	.283	65.6742	.2637		
ER2001	INV	.055	27	1.57	.221	74.7492	-66.531		
ER2001	CUB	.082	25	.74	.538	39.1246	5.3588	-.2878	.0050

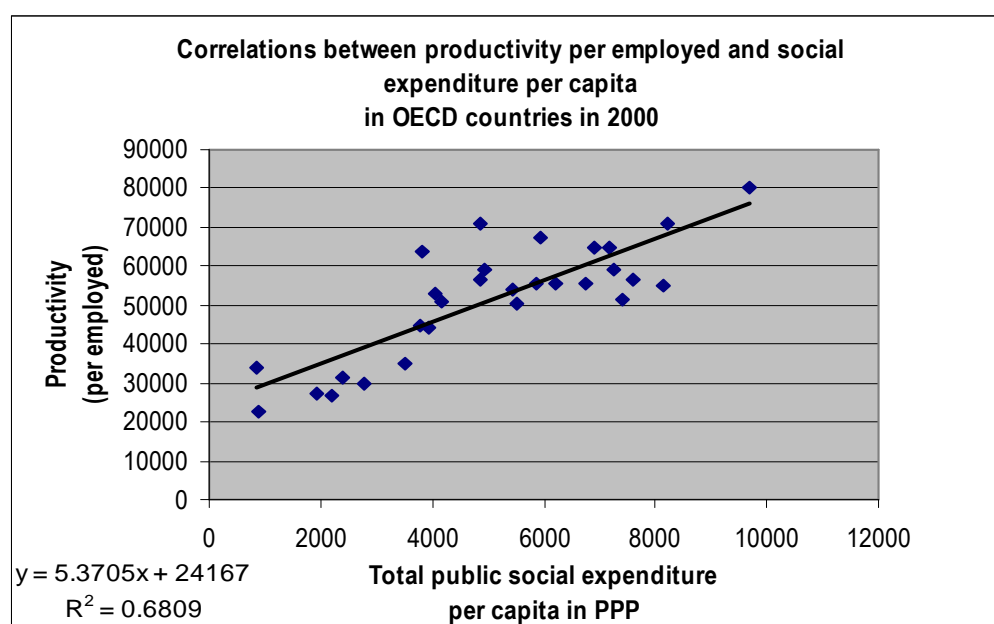
**Figure 10. Labour productivity per hour and social expenditure, OECD countries, 2001**



Source: ILO calculations, based on OECD/SOCEX data base.

The correlation between “simple” per capita (per worker) productivity and social expenditure (per capita of the population) is still positive but less tight.

**Figure 11. Labour productivity per worker and social expenditure**



Source: ILO calculations, based on OECD/SOCEX data base.

The above relationship also seems to hold true for non-OECD countries. The data situation is weaker, so we limit ourselves to analysing the relationship between health expenditure per capita and hourly and per-worker productivity. Health expenditure is seen as the part of overall social expenditure that has the most direct impact on maintaining the productivity of workers.



Figure 12. Health expenditure per capita and hourly productivity, Non-OECD countries, 2001

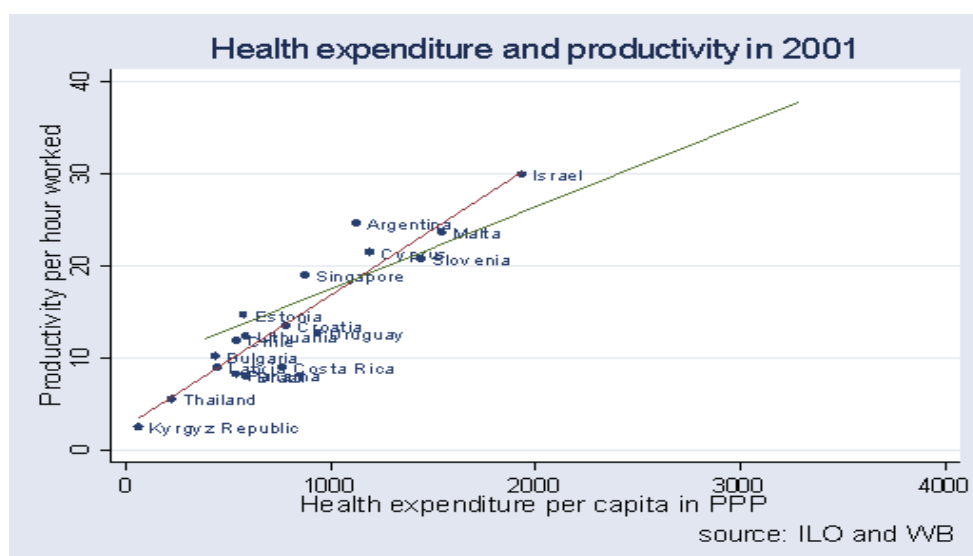
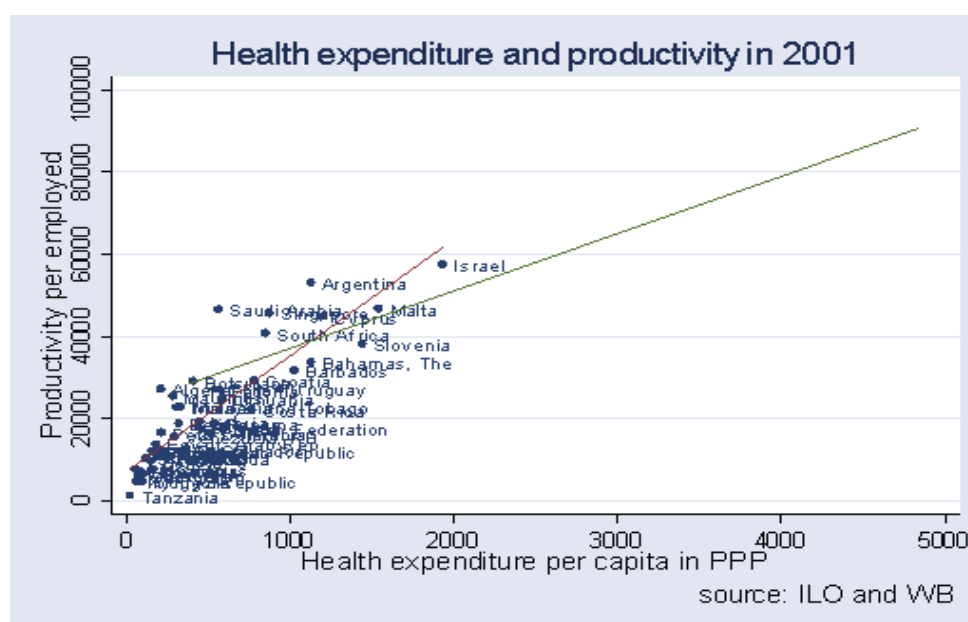


Figure 13. Health expenditure per capita and productivity per worker, non-OECD countries, 2001



The above observations can be subject to different (and to some extent contradictory) interpretations:

- A) The standard interpretation is, of course, that social spending can be increased with labour productivity. Only productive economies can spend significant amounts of social protection. The lower labour productivity, the less can be spent, accordingly. This argument could be supported by the fact that much of social protection in OECD countries is financed through taxing labour income (wage related contributions/taxation).
- B) Another interpretation could be that there is an inherent necessity of social spending when labour productivity is high. One could argue that human capital operating at high productivity is – similar to physical capital - subject to a high “depreciation rate”.

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Social protection would then have to be interpreted as measures compensating for the depreciation of human capital. Unemployment benefit systems and pension systems would then be interpreted as systems that allow for a human “escape” of exhausted labour from the production process. Health care would be interpreted as a system operating in order to try to maintain the productive capacity of labour extending the potential time that a worker can remain in the production process.

- C) Interpretation B, in some of its aspects, comes close to the last possible interpretation considered here. In case C, one would argue that social protection (spending) has direct and indirect positive effects on labour productivity. In addition to the effects mentioned under B, interpretation C would, by contrast, focus more on the indirect effects. Positive productivity effects of social security would emerge from the relative financial security provided that it, *inter alia*, reduces the distraction of workers from their prime occupation, facilitates the restructuring of labour markets and hence ensures that workers are employed in the most productive jobs possible and possibly from other effects working in the same direction. In addition, there can be very little argument contesting that access to health care and occupational health and safety services has positive, productivity-enhancing impacts on health.

Among the above three interpretations it is especially interpretations B and C that seem to be offering attractive space for further research.

Even if observers do not feel to be in a position to decide on one of the options, one important fact should not be overlooked, when interpreting the above results: There is nothing in the empirical findings on the correlation between productivity and social expenditure suggesting that high spending on social protection is associated with low productivity. On the contrary, there seems to be strong empirical evidence indicating that high productivity (only) materializes if accompanied by high social spending.

If one juxtaposes that finding with the very low level of correlation between employment levels and the social expenditure ratio, the conclusion has to be that some social security systems might discourage labour force participation. This is not a general rule as the case of Sweden, Norway and Switzerland show where relatively high levels of social expenditure coincide with high levels of employment. Apparently, the institutional arrangements that govern the transfers can create positive 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. However, likewise, there is thus no reason to believe that relatively high levels of social expenditure automatically lead to a compression of potential levels of GDP.

In a recent textbook a group of ILO experts conclude that “it is probably fair to conclude that economic theory and evidence alone do not give us a clear-cut answer as to what the net effect of the different kinds of welfare states on economic performance and hence the welfare of the population is [...] However, what we have learned confirms previous findings that social protection measures can indeed achieve positive social outcomes and do not strangle economic development. That is encouraging.” (Cichon, Michael and Scholz, Wolfgang et al. (2004), p. 150).

## **5. Conclusion: Three famous myths lose credibility**

Let us face the facts. What we would like to see is, of course, a solid proof of positive causality between a decent level of social expenditure and economic growth. Our regression analyses - like all regression analyses - fail to provide that proof. That is regrettable, but social policy makers can probably live without that mathematical proof. In the course of this paper we think we have sufficiently discredited three famous myths.

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(1) The poverty alleviating trickle-down effect of economic growth is not reliable

We can show high levels of correlation between poverty levels and social security expenditure on the macro-level. We can also show by micro-analytical instruments how the direct redistributive mechanism work can reduce poverty. We also showed that economic growth does not automatically reduce poverty without putting redistributive mechanisms (such as social security systems) in place. There is thus a good case for social transfers as poverty alleviation mechanisms and hence as a mechanism to foster social development. The only argument that could discredit the (early) introduction of social transfers is that they would cripple economic growth to such an extent that the resulting loss in welfare would actually lead to higher long-term levels of poverty.

(2) The famous trade-off between social expenditure and economic performance does not hold

What we know is that extensive social protection expenditure per capita and high productivity can co-exist, we know that high social security does not automatically suppress employment and hence we know that high social expenditure and top economic performance can co-exist. Hence – strictly speaking from the point of view of mathematical logic - the opposite neo-classical trade-off between equity and efficiency does not hold true.

(3) There is no strict limit for national social expenditure depending on the level of economic development

In many discussions on levels of social security expenditure in ILO member States non-affordability arguments are fielded, i.e. that certain countries cannot afford more than a certain level of expenditure at a given state of economic performance. Most of such general arguments appear unfounded. We have observed at various stages of the above analysis that at any given level of GDP per capita there is a wide range of social expenditure between different countries. The latter implies that conditions differ from country to country (for example the demographic situation) but also that there is considerable policy space with respect to choosing the level of national social expenditure (and incidentally public expenditure in general).

Where does it leave us?

There is certainly a need for a more a more detailed research to get out of statistical inconclusiveness and the lack of proof for causality. There may be also – or almost certainly is - a saturation point for social expenditure beyond which it becomes economically and socially counter-productive. We do not know where that point is. It will be dependent on specific national circumstances and the specific design of the transfer systems and the affiliated incentives. But this point is far away for most countries, notably in the developing world. At the moment, countries like Denmark and Sweden with an SER of almost 30 per cent do not show any sign of having passed that saturation point. Others at lower levels may have. So, for the majority of the countries in the world, reaching the maturation point is not a real risk.

When governments, social partners and civic society are shaping policies for low- and middle-income countries, as well as most high-income countries, it should suffice to know that social security systems:

- reduce poverty and inequality;
- are compatible with high economic growth,

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provided they are designed right, do not lead to waste and perverse objectives. When making national social security systems an explicit feature in national developments policies, the critical question should not be whether this is the right thing to do, but how to do things right.

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