10

Social Policy and the Elimination of Extreme Poverty

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In 1990 approximately half of the population in the developing world lived on less than US$1.25 a day. By 2010 some 700 million people had been lifted out of poverty, dropping that rate to 22 percent, and fulfilling the first Millennium Development Goal of cutting extreme poverty in half (UN 2014). Still, a billion people continue to live below the $1.25-a-day line, and achieving the "last mile" in eradicating poverty will require a different set of instruments, institutions, and policy regimes than has been commonly used.

This chapter argues that, although much progress against extreme poverty in low- and middle-income countries has been accomplished through so-called inclusive growth, the elimination of consumption-based poverty will require greater attention to the political economy of social protection in developing nations. Since the 1990s, increases in labor-based income have been responsible for most of the achievement in poverty reduction. But for the large middle-income countries (where most of the world's extreme poor currently live), evidence suggests that the effect of labor income on consumption will hereafter diminish considerably, with the poorest individuals remaining vulnerable to a variety of shocks, thus requiring a more effective social floor below which they cannot fall. In middle-income countries, it may be that growth has lifted

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all the poor out of extreme poverty who can be lifted; for the rest, social policy will be needed.

What kind of social policy mix is needed? While it is technically possible to devise precise, leakage-free, redistributive mechanisms that can raise consumption among the extreme poor and protect those on the edge of poverty, the political reality is that critical support among the nonpoor for these types of schemes is the lowest where it is needed most, namely, in countries with large populations of extreme poor. Consequently, if these countries continue their typical policy mix of "inclusive" growth strategies combined with targeted transfer programs, movement along the last mile will be slow. Instead, the last mile in poverty reduction is more likely to be sustainable through comprehensive, even universal, social policies in which the nonpoor are included.

By 2030, however, most of the world's extreme poor will live in fragile states, many of which are low-income countries. In these countries, of course, there remains much mileage to be gained from growth. However, reforms to social policies in these countries also have their place. Here the challenge is to weave together the various strands of highly fragmentary antipoverty programs into more uniform, effective systems of social protection that preserve cohesion.

Much of this chapter draws upon the history of poverty reduction and social policy reform in advanced, industrialized economies. Of course, countries in the developing world have followed different trajectories—with respect to the timing of industrialization, reliance on service sectors, and the role of the state in the economy in the context of postcolonial development. This chapter argues, however, that the mechanisms by which extreme poverty was reduced in richer countries when those countries were much poorer—through "welfare states" financed through a tax system in which all citizens held a stake, but that also reduced the multiple vulnerabilities faced by the poor—apply with equal force in developing countries today. From Brazil to India to sub-Saharan Africa one already sees hints of these historic forces at work: a long-undermined commitment to the tax system; middle-class resentments against corruption and poor service delivery; and a political awakening that has upended long-lived alliances between ruling elites and particular constituencies in which the middle classes are sidelined. Indeed, the process of welfare-state building—much like state building itself—has not been a peaceful one. In Western Europe and in the United States in the nineteenth and early twentieth centuries, it was characterized by social unrest, political extremism, and economic turmoil. Whether countries where the extreme poor live can develop durable institutions of social protection will depend on a number of factors, including the broader macroeconomic environment, the effect of globalization on the types of risks countries face, the establishment of domestic political alliances between the poor and the nonpoor, and the ability of aid recipients to temper the strong preference for targeting among the donor community.

Inclusive Growth and Its Discontents

The idea of inclusive growth has taken a central role in debates on developmental trajectories and poverty reduction, despite a lack of a consensus on the meaning of inclusive growth and its relative, pro-poor growth (Ranieri and Ramos 2013). The general idea is that a growth strategy should aim at some combination of income growth and progressive redistribution that raises the living standards of lower-income groups along with the mean. The OECD's Development Assistance Committee (DAC) issued its own statement, stating that pro-poor growth focuses attention on the extent to which poor people are "able to participate in, contribute to, and benefit from growth" (OECD 2006). The idea that both the speed and distribution of income growth are critical for achieving economic development as well as poverty reduction is consistent with the findings of the Commission on Growth and Development (World Bank 2008), which notes that inclusiveness—encompassing equity, equality of opportunity, and social protection—is an essential ingredient of any successful growth strategy.

It is important to note that unambiguously inclusive growth has been a rare phenomenon in the past few decades. An IMF study of the developmental trajectories of 101 low- and medium-income countries, for example, finds that 78 of them experienced per-capita income growth of more than 1 percent per year over a twenty-year period (Anand, Mishra, and Peiris 2013). Of these growing countries, fewer than half increased income equity over the same period.

There are several reasons why this has been the case. Many of the major sources of growth—globalization, financial deepening, investment—can each lead to greater inequality even as they raise incomes. Trade openness, for example, can expand wage gaps between skilled and unskilled workers. Similarly, both inward and domestic investment can raise the premiums for workers with higher education. Financial depth, if imperfect markets for credit and insurance are a result, can widen the difference in opportunity costs of capital between the poor and the nonpoor. In particular, price instability during financial liberalization can increase the vulnerability of the poor, who typically do not have access to inflation-hedging instruments. Additionally, as is well known, macroeconomic stability—considered to be one of the proximate factors leading to inclusive growth—can be difficult to achieve in commodity-dependent economies. Growth can also create poverty where economic shifts bring technological advancements, changes in property rights, and labor market dislocations that can dispossess, exclude, or impoverish large numbers (Saad-Filho 2010). Poorer, less-educated workers may be unable to find alternative employment with equivalent pay, or may be unable to obtain the training needed to seek better prospects in other economic sectors. In the Arab world, for example, younger job market entrants have for two generations consistently found fewer employment opportunities than their older counterparts. The policy response to these conditions—the promotion of self-employment—has also foundered due to insufficient access to credit and markets (Assaad and Levinson 2013).

Concerns have been raised about the feasibility of achieving inclusive growth by redistribution alone (Ianchovichina and Lundström 2009). Transfer schemes can impose fiscal burdens, and where average incomes are very low, redistribution with growth may be difficult to achieve. Instead, analyses of the sources of poverty reduction show that labor income growth contributes more to poverty reduction than transfer schemes, with labor income explaining between 40 percent and 50 percent of the reduction in poverty. However, transfers and nonlabor income have a much stronger effect on reducing extreme poverty (Azevedo and others 2013). This is related to studies that have attempted to measure the inclusiveness of growth as a combination of growth in income and growth in equity. These studies find that inclusive growth is most associated with reductions in poverty when the initial extreme poverty rate is high; for those countries with lower extreme-poverty headcounts, inclusive growth has a smaller impact on reducing poverty (Anand, Mishra, and Peiris 2013). These findings, together, suggest that, while labor income has been the key factor behind reducing extreme poverty from very high initial levels, job creation may have diminishing impacts on the last mile of poverty reduction.

Pushing the Limits of Inclusive Growth: The Case of Brazil

Brazil's experience, in this regard, is illustrative. Brazil's industrialization began in earnest in the 1930s under the Estado Novo, which transferred power away from coffee barons, and which led to the expansion of important sectors of the economy including the automobile industry, petrochemicals, and steel, as well as to the initiation and completion of large infrastructure projects (see, for example, Baer 2008). After a brief period of stagnation in the early 1960s, a series of market reforms created the basis for the export-led "miracle" years, primarily by moving the poor out of subsistence agriculture. The impressive growth in income during these decades—among the highest in the world—is shown in table 10-1. Labor income growth was certainly responsible for much of the progress against poverty achieved by Brazil between the 1950s and 1970s. In the 1960s, for example, for three-quarters of Brazil's economically active population, wages were the only source of income, and the income received by wage

Table 10-1. *Growth and Poverty in Brazil, 1951–2008*
Percent[a]

Period	*Output growth*	*Output per capita growth*	*Output per worker growth*	*Total factor productivity growth*	*Extreme poverty rate*	*Reduction in extreme poverty*
1951–66	6.36	3.24	3.27	0.96	40.5	1.40
1967–79	8.90	6.22	5.67	3.08	21.7	1.41
1980–2008	2.47	0.77	–0.38	–1.13	11.4	0.27

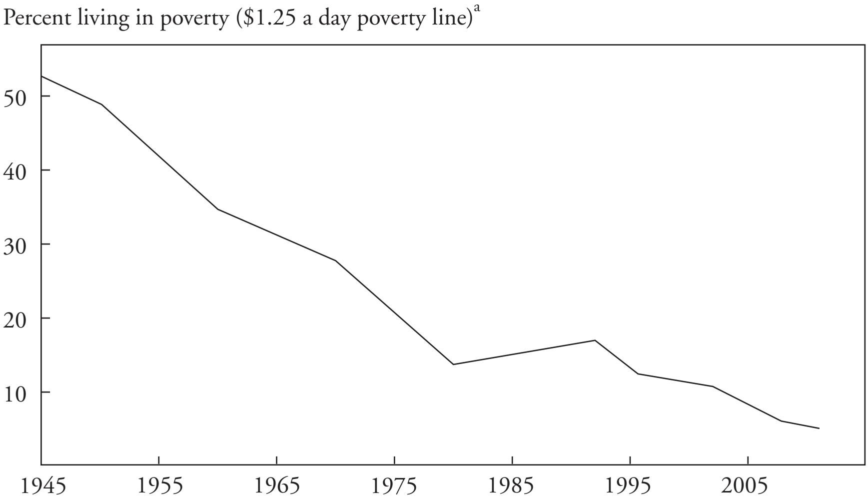
Source: Cardoso and Teles (2010); World Bank, Povcalnet Database.
a. Figures are in annual percentages, averaged over the relevant time period.

earners was 71 percent of the total (Fields 1977). By the 1970s, however, the problem of extreme poverty—particularly in rural areas—proved to be resistant to economywide income growth (Heimer 1975). More important, the specter of rural unrest—particularly in the northeast—prompted the military government to act (Schwarzer and Querino 2002; Haggard and Kaufman 2008).

The incorporation of rural workers into an institutionalized relationship with the state, along with the regulation of rural labor relations, became central components of the military's agrarian policies (Houtzager and Kurtz 2000). Social security had been extended to the countryside by law in 1963 but had not been implemented. In 1971, however, the military government in Brazil launched one of its watershed social initiatives, namely, the extension of noncontributory pensions to peasants and the rural poor through the Rural Worker Assistance Fund (FUNRURAL). By the end of the decade, some 90 percent of the population had been given entitlements to a wide range of social assistance programs. With the 1988 constitution, social assistance became a "social right" in Brazil, granting special protection to families, mothers, children, youth, elderly, and persons with disabilities (Robles and Mirosevic 2013).

These noncontributory programs helped Brazil cut the rate of extreme poverty by more than half, from almost 30 percent in 1970 to less than 14 percent in the 1980s (figure 10-1). In subsequent years, these programs were followed by the unconditional Benefício de Prestação Continuada (continuous cash benefit) and the conditional Programa Bolsa Família (cash-transfer programs)—both considered instrumental in poverty alleviation. As indicated in table 10-1, since the 1950s, Brazil has halved its poverty rate approximately every twenty years. For the first forty years, that poverty reduction can be attributed to growth in wages. But the effect of social protection on progress in the last mile in Brazil cannot be understated: after the 1980s, when Brazil (like other Latin American nations) saw poverty rise, the extension of social protection to previously

Figure 10-1. *Rates of Extreme Poverty in Brazil, 1945–2010*



Source: Bourguignon and Morrisson (2002); Maddison (2007); World Bank (various years: *World Development Indicators*).

a. Poverty ratios are calculated from parameterized Lorenz curves derived from historical data.

excluded groups drove poverty down from 12 percent to 6 percent. Transfers from Bolsa Família alone are responsible for lifting over 20 million Brazilians out of extreme poverty since the program was launched. In one of the most income-unequal countries in the world, the incomes of the poorest Brazilians rose seven times as much as those of the richest (Rosenberg 2011). In 2011, the Brasil Sem Miséria (Brazil without misery) program expanded the Bolsa Família, as well as health and education programs. In addition, it directed more money to Brazil's poorest regions, with the goal of lifting the 16 million "most destitute" out of poverty. Early in 2013, Brazil's President Rouseff announced that the last mile would soon be completed.

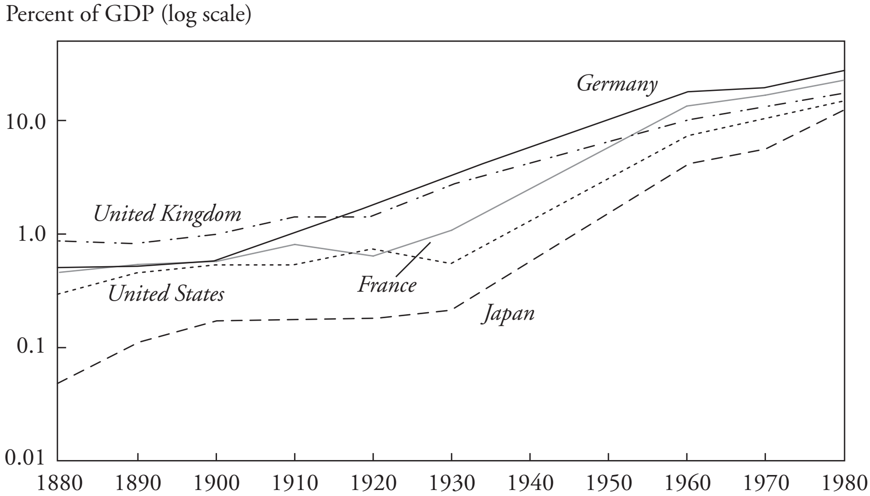
Social Protection: Building the Welfare State

Significant evidence suggests three main mechanisms by which social protection reduces poverty. First, social protection promotes better access to public services and increases investment in human capital, particularly via health and education, helping raise productivity and labor participation rates among the poor. Second, social protection enables poor people to protect themselves and their assets against shocks and reduces the likelihood that households, during hard times, will engage in behavior that is destructive over the long term, such as withdrawing children from school or selling productive assets. Third, social protection, by enlarging the assets and capabilities of poor people, better enables them to coordinate in factor and product markets, mobilize resources, and gain access and representation in the design and implementation of policies that affect their lives. Critical to the effectiveness of social protection, however, are the public institutions that support social assistance and social insurance—the nature of the "welfare" regime—that facilitates access to the labor force as well as insurance against risk.

An important intellectual innovation in the eighteenth century was that poverty should no longer be thought of as a necessary condition for development, that the afflictions of extreme poverty—hunger, disease—encourage industry and work or that the prospects for upward mobility among the poorest were restricted: "The key contribution . . . was in establishing the moral case for the idea of public effort toward eliminating poverty" (Ravallion 2013). For the better part of a century, that "public effort" largely took the form of mutual aid societies, the workhouse, and compulsory education laws. It did not include any form of protection against shocks or any social "floor."

But after social upheaval among the growing urban, industrial workforce in the late nineteenth century, the political movements—parties, revolutionary communes, labor radicalization—that it spawned were responsible for much of the policy responses to come (figure 10-2). In the 1880s, Bismarck's government enacted the Law Concerning Health Insurance for Workers (1883), the Accident Insurance Act (1884), and the Law on Invalidity and Old Age Insurance for Workers, Journeymen and Apprentices (1889). In this way the modern welfare state was born. The political circumstances behind the expansion of social protection not just in Brazil but all across Latin America partly mirror the nineteenth-century German experience: states seeking to dampen unrest through the extension of benefits to key segments of the population. In Bismarck's own words, "My idea was to bribe the working classes, or shall I say, to win them over, to regard the state as a social institution existing for their sake and interested in their welfare" (Dawson 1894). After the 1890s, France established free medical assistance and assistance programs for the elderly. Facing similar trade union mobilization and electoral threats from the newly formed Labour Party, Britain soon followed suit, with the governing Liberal Party after the 1906 elections enacting a series of welfare reforms that dealt with worker pensions, unemployment, and health insurance. The Great Depression precipitated the Social Security Act and Fair Labor Act in the United States. Beginning in the 1920s, finally, the Japanese government enacted a series of welfare programs, although comprehensive social security was not established until after World War II.

Figure 10-2. *A Century of Social Spending, Five Industrialized Nations, 1880–1980*[a]

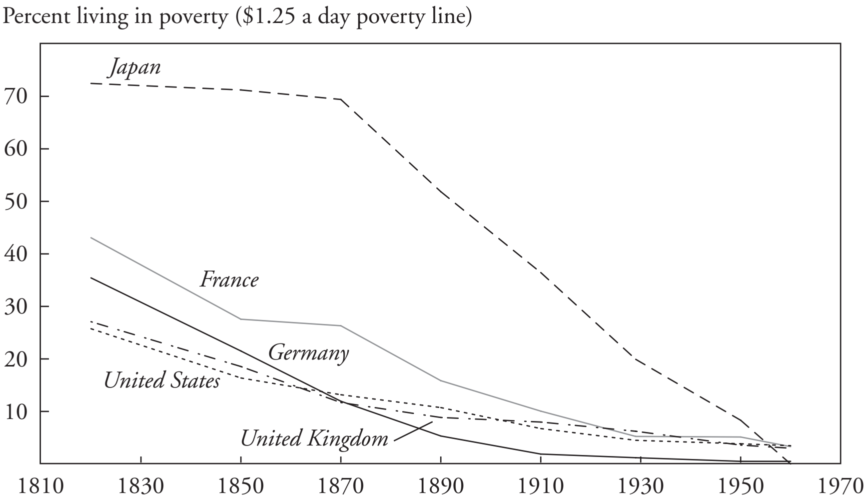


Source: Lindert (1994); OECD.
a. Social spending comprises public expenditures on pensions, health, welfare, and housing.

These rudimentary welfare regimes did not involve large public expenditures in relative terms. As figure 10-2 shows, in all cases all public spending on welfare, pensions, health, and housing remained below 1 percent of GDP in five industrialized economies, at least until the 1930s. Extreme poverty in these states, however, fell during that same period (figure 10-3), with much of that reduction driven by increases in wage incomes. In Lindert's (1994) classic formulation, much of the expansion in social spending began with the organization of labor and the spread of the democratic franchise in these countries in the late nineteenth century. By the post-World War II years, however, these countries had approached their own last mile, with between 3 percent and 5 percent of the populations of the United States, the United Kingdom, Germany, and France living below $1.25 a day in 2005 PPP-adjusted U.S. dollars (Japan's rate was higher, at approximately 15 percent).

The prospect of rising unemployment following the war prompted the British government to investigate the constraints facing social insurance schemes and to reform existing workers' compensation programs. The Beveridge Report (Beveridge 1942) recommended extending the scope of social insurance to cover excluded individuals (for example, children and pensioners), to expand the range of risks against which insurance could be provided, and to raise the rates of benefit. Under the postwar Labour government, the National Health Service

Figure 10-3. *Poverty Rates, Five Industrialized Nations, 1810–1970*[a]



Source: Bourguignon and Morrisson (2002); Maddison (2007); World Bank (various years: *World Development Indicators*).

a. Poverty ratios are calculated from parameterized Lorenz curves derived from historical data.

and a national social security system formed the core components of the current British welfare state. These reforms were to emphasize contributory benefits. Or, as Beveridge put it: "Benefit in return for contributions, rather than free allowances from the State, is what the people of Britain desire" (Beveridge 1942). Thereafter in postwar in Western Europe, similar mixed-economy bargains fueled much of the expansion in social spending and contributed a greater portion to the elimination of extreme poverty in these countries (Shonfield 1965). In the United States, the Johnson administration's War on Poverty similarly aimed at extending social protection to excluded persons and expanding the types of risks covered through such initiatives as Medicare, Medicaid, food stamps, and Head Start. Evidence suggests that the percentage of Americans living above the national poverty line fell from 26 percent to less than 15 percent by the early 1970s, with much of the effect of poverty reduction concentrated among the elderly (Wimer and others 2013).

Divergences among Developing Countries

In the nineteenth century the German economist Adolph Wagner developed the income-effect explanation for social spending for which he is famous: that industrialization would create political pressures for greater social spending. While there is weak support for Wagner's "law" in high-income OECD countries (Lindert 1996), economic development appears to be unrelated to the size or expenditure of government among developing countries (Adsera and Boix 2002; Mares and Carnes 2009). Indeed, explaining variation in social spending among middle- and low-income states has remained something of a puzzle for political economists.

Despite well-known structural differences in welfare states, the postwar systems of social protection that evolved in advanced industrialized economies were principally contributory in nature, with benefits for workers being paid for by their employers through a tax proportional to their wages. Subsequently, social protection regimes expanded to noncontributory programs financed by general tax revenues. While contributory social insurance links the level of contributions to the wages of individuals (ensuring that the rich contribute more than the poor), noncontributory policies finance benefits from general tax revenues. The context in which social protection developed in OECD countries, however, differs from that of middle- and low-income countries along three dimensions: one, the weaker relative bargaining strength of the labor movements; two, a larger informal economy, with consequences for coverage in social programs; and three, greater reliance on targeting in delivering social protection.

Globalization and Organized Labor

Social protection in low- and middle-income countries evolved in an environment in which labor movements have found themselves in a weaker bargaining position relative to the holders of capital. One of the enduring puzzles in the development of social protection around the world is the divergence between high-income OECD countries and developing countries in this regard (Rudra 2002, 2009). While the former were able to prosper and expand social protection programs in an era of capital mobility and international competition, in the latter austerity and neoliberal reforms limited public expenditures on social protection and poverty alleviation (Rodrik 1997, 2008). The divergence is commonly explained by the familiar race to the bottom, whereby economic openness discourages social and welfare spending. As holders of capital push for lower taxation (and expenditures) along with less debt and, at the same time, oppose policies that can lead to rises in unit labor costs, the bargaining ability of workers to resist these pressures shrinks (Garrett 2001). Consequently, for developing nations with large surpluses of low-skilled labor, globalization may have placed labor in a weakened position.

A similar argument makes a distinction between groups within sectors facing shocks (manufacturing sectors exposed to international competition, for example) relative to those less vulnerable. In this view it is distributional conflict between the high- and low-risk sectors, rather than between classes, that shapes social protection. Workers and firms facing high demand volatility, consequently, will favor institutions of social insurance that compensate them for losses of income and that reallocate these costs across sectors; workers and firms in low-risk sectors will oppose these programs that turn them into subsidizers of high-risk sectors (Mares 2005). The outcome of this battle turns both on the relative bargaining strengths of these groups and on the government's ability to manage conflicts and enforce existing policies, which can dampen the effect of external shocks on the erosion of social protection.

Fragmentation and Coverage

While an industrial base of formal sector workers drove the expansion of contributory social protection in OECD countries, informality in many developing countries has fragmented the nature of the social protection regime. The vast majority of the population in low-income countries is not covered by any form of statutory social protection, either insurance based or noninsurance based, with the result that the majority of the workforce is excluded from social insurance. Moreover, the poor find that the social protection services offered by statutory coverage, such as pensions and unemployment benefits, do not match priorities like consumption smoothing, childcare, and basic education (Norton, Conway, and Foster 2001). One explanation stresses the long-term effects of structural changes in the economy linked to "deindustrialization" in the developing world, whereby the growing ranks of self-employed workers in the service sector have very different individual preferences over social policy alternatives (Carnes and Mares 2010). This also potentially explains divergences between East Asia and Latin America.

In Latin America, formal sector workers are forced to consume a bundled set of goods and services largely paid by payroll taxes (and a smaller portion by government subsidies), while in the informal sector workers can choose which goods and services (of the offered menu of social protection) to consume, and their cost is financed out of general government revenues. As a result, employment in the formal sector is taxed (because workers do not value the benefits in full), while employment in the informal sector is subsidized (Levy 2008). In combination, these labor market differences also increase the size of a potential political coalition favoring noncontributory social policies, perpetuating the fragmentation of social policy, and creating an environment in which the temptation to use antipoverty programs for political benefit is strong. Latin America is replete with examples. In Peru, before elections, Fujimori's government often poured money into the FONCODES public works and antipoverty programs (Schady 2000). In Mexico, between 1989 and 1994, the national poverty-alleviation program, Programa Nacional de Solidaridad (PRONASOL) spent 1.2 percent of GDP annually on transfers heavily skewed toward municipalities dominated by the governing Institutional Revolutionary Party (PRI) (Diaz-Cayeros and Magaloni 2003). Whatever their effects on poverty, Mexico's

PROGRESA-Oportunidades and Brazil's Bolsa Família have also yielded electoral rewards for incumbent politicians (De La O 2010).

By contrast, a lower degree of relative informality in East Asia has important implications for its social policy preferences. The expected utility derived from contributory insurance should be higher. Moreover, rising insecurity among this group—due to greater reliance on low-skill, service sector employment, exogenous economic shocks, and demands for labor market flexibility—would also increase support by these workers for policies with a stronger pro-poor bias (Mares and Carnes 2009). Although there is evidence of the relatively larger size of intrafamily transfers in East Asian states (Kwon 2005; Kim 2005), a significant portion of the welfare mix is provided through employer-provided benefits (Kim 2010). Moreover, several East Asian countries are characterized not only by higher levels of coverage but also by high levels of redistribution across income groups when compared to Latin America (Mares and Carnes 2009).

Targeting

Finally, social policy in low- and middle-income countries reveals a strong preference for targeted benefits. In the 1980s and 1990s many developing countries shifted away from broad social policies that emphasized universal benefits toward an approach that targeted public resources to vulnerable segments of the population. Targeted interventions had been designed with a number of specific goals: reducing hunger, increasing income and employment, enhancing the skills of the poor, providing assistance to migrants, launching labor-intensive public works, transforming low-yielding self-subsistence farming into modern agriculture, closing the gap in living standards among ethnic groups, improving education, increasing the share of women in wage employment, combating gender violence, and involving youth in safety enhancement and community awareness projects (see for example, Ocampo 2008).

It is important to distinguish between inefficiently targeted transfers and the inefficient transfers themselves. While the former may be needed to ensure that social programs are politically sustainable, the latter impose distortions on the economy. Pro-poor redistribution sometimes takes a highly distortionary form due to the lack of transparency in budgetary rules or due to high levels of discretion in spending. Some of these extremely inefficient transfers to the poor are well known, like the urban bias in some countries, whereby price subsidies for urban residents are implemented at the expense of poor farmers, and the use of off-budget funds that may have antipoverty components but that constitute a contingent fiscal liability for governments. These distortionary transfers sometimes occur as a way of masking the true cost of the transfer (Acemoglu and Robinson 2001). Thus politicians rely on price subsidies rather than lump-sum transfers, or on off-budget funds rather than budgetary expenditures, in order to avoid revealing the true cost of the transfer and the political relationship between the politician and the beneficiary group. Above all, politicians want to avoid appearing to care about the poor to the exclusion of others.

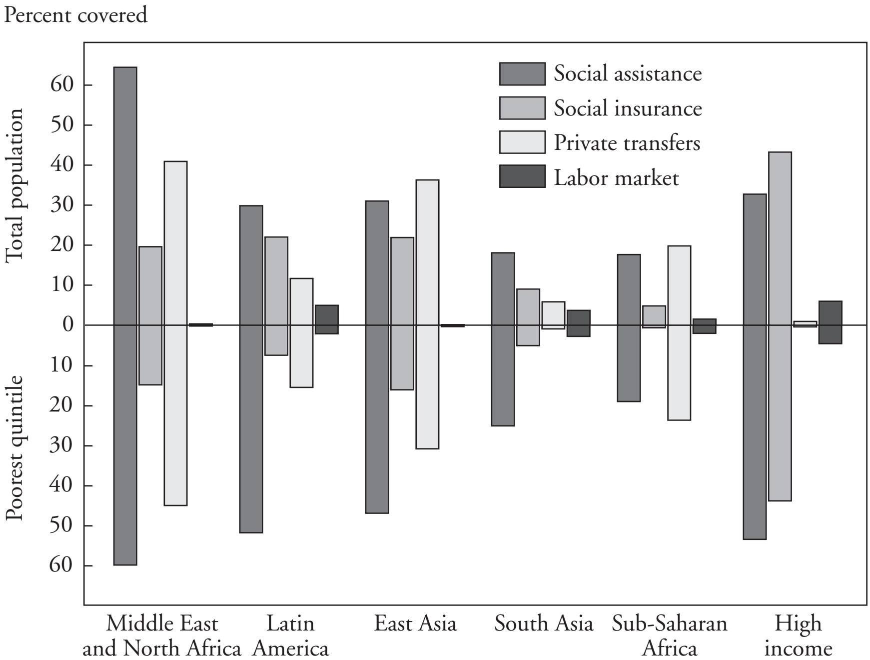
Although OECD welfare includes minimum wage laws and allowances to those below the poverty line, they have gone much further in the universal provision of education, health insurance, and child allowances. While targeting mechanisms aim to minimize the cost of programs by focusing social protection on the poorest households, over one-quarter of social programs in developing countries were found to have regressive outcomes, indicating that a universal approach would have distributed a greater proportion of benefits to the poor (Coady, Grosh, and Hoddinott 2004). Moreover, the total redistributive effect may be higher in universal systems than in those countries that apply targeting (Korpi and Palme 1998; Ocampo 2008).

Social Protection as a Developmental Process

Before 2000 few middle- or low-income countries provided what might be termed a social safety net with wide coverage. According to the ILO's definition, 80 percent of the world's population has no access to "comprehensive social protection" (Bonilla Garcia and Gruat 2003). The content of social protection programs was either generally highly targeted to certain groups (extreme poor, disabled, elderly, rural residents) or was provided through full-employment policies relying on the public sector (as in the case of several middle-income countries in the Middle East and North Africa). Since then, there have been the spread of cash transfer programs in Latin America and the introduction of universal social policies in Korea, a social protection floor in China, and a countrywide public works program in India.

Moreover, despite the spread in social protection, coverage remains uneven. Figure 10-4 compares coverage ratios across regions of four types of social programs: social assistance (cash and in-kind transfers), social insurance (pensions and social security), labor market programs, and private transfers (remittances). Coverage for the whole population and for the poorest quintile is compared across the upper and lower portions of the figure. The graph highlights three facts about comparative social policy. First, most social programs are not very pro-poor. With the possible exception of social assistance programs in some regions, the coverage shares of the general population and the poorest do not differ remarkably. Second, richer regions appear to rely on social insurance more than social assistance. As one would expect, social insurance coverage ratios are generally skewed to the nonpoor, reflecting their greater participation in contributory social programs. Finally, there is considerable regional variation, both in terms of program coverage, as well as progressivity.

Figure 10-4. *Social Protection Coverage by Program Type and Region*[a]



Source: World Bank (various years: *Atlas of Social Protection*).

a. Programs are categorized as social assistance (cash transfers, family allowances, subsidies, and food/cash-for-work programs), social insurance (contributory pensions and social security), labor market programs (unemployment benefits, severance, disability, vocational training), and private transfers (remittances, both domestic and cross border). Data are 2004–11 averages.

The constraints affecting the construction of social protection systems in developing countries can be further seen in table 10-2, which shows that total average budgetary allocations from the general government to social security, health, education, and welfare did not move by much more than 1–3 percent of GDP for low- and middle-income countries, respectively, between the 1970s and 2000s. High-income OECD countries, by contrast, expanded their combined social spending by more than 10 percent of GDP during the same period.

Using historical estimates, one can also compare developing countries to high-income countries in terms of their progress against poverty based on income levels. Figure 10-5 does this for three industrialized and three developing countries over the course of almost two centuries: Germany, United Kingdom, United States, China, India, and Indonesia, between 1820 and 2010. The right side of the curve illustrates the last mile that the richer countries completed several decades ago. But the graph also shows that today's developing

Table 10-2. *Social Spending by Category and Income Group, 1970s–2000s*[a]
Percent of GDP

Income group and category	*1970s*	*1980s*	*1990s*	*2000s*
Low- and lower-middle-income countries				
Social security and welfare	1.47	1.58	2.07	3.19
Education	3.29	3.37	3.50	4.37
Health	1.32	1.46	1.62	1.58
Total	6.08	6.41	7.19	9.14
Upper-middle-income countries				
Social security and welfare	3.86	4.27	5.40	4.55
Education	3.75	3.80	4.02	4.57
Health	1.59	1.81	2.00	3.04
Total	9.20	9.88	11.42	12.16
High-income OECD countries				
Social security and welfare	14.88	16.71	17.83	22.64
Education	6.18	6.96	6.49	5.35
Health	4.84	6.42	6.75	7.36
Total	25.90	30.09	31.07	35.35

Source: Rudra (2008); World Bank various years (*Atlas of Social Protection; World Development Indicators*).

a. All figures are annual averages expressed as percentages of GDP. Figures for the 2000s are for 2004–11.

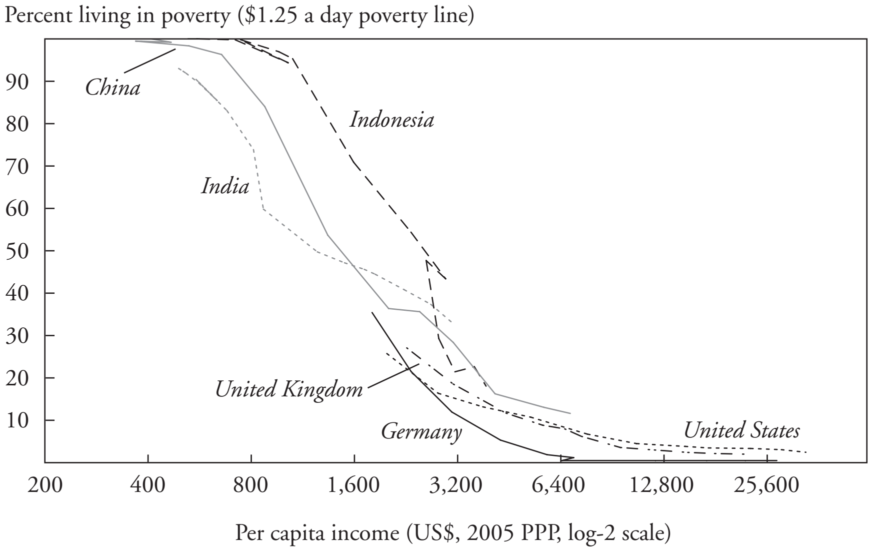
nations have higher poverty rates than the industrialized nations did when they were at comparable levels of per-capita income.

More important, these Asian states are also lagging behind in their development of social protection when compared to richer nations at equivalent periods historically. In per-capita income terms (in 2005 purchasing power parity adjusted for international dollars), India today is richer than Germany was in the late 1880s, when Bismarck created contributory social insurance programs for all workers. Indonesia is as rich as the United States was in 1935, when it passed the Social Security Act. And China is richer than Britain was in 1948, when it inaugurated the National Health Service.

Protection of the Poor and Middle-Class Exit

What explains the comparative lag in welfare state development between developing countries and industrialized countries at historically comparable levels of per-capita income? Classic explanations of the expansion of social protection

Figure 10-5. *Progress against Poverty, Six Countries, 1820–2010*[a]



Source: Bourguignon and Morrisson (2002); Maddison (2007); World Bank, *World Development Indicators;* Luxembourg Surveys.

a. Each line shows poverty headcount ratios for each country against per capita income, starting in 1820 and ending in 2010. Poverty ratios are calculated from parameterized Lorenz curves derived from historical data.

in Western Europe and North America feature the critical role of the emerging industrial (and later white-collar) middle class. From this perspective, the political position of this new middle class was instrumental in consolidating the welfare state (Esping-Anderson 1990). Where the middle class allied with the urban working poor or farmers, for example, governments managed to institutionalize middle-class loyalty to broader systems of social protection. Welfare states in industrialized nations, as described above, were not built for the poor but for workers (to prevent social unrest). But they accommodated needs of the middle class by providing services for which they would be willing to pay taxes (Deacon 2010). In the advanced economies, as the middle class acquired a greater stake in a contributory system, they also demanded accountability, legal protection, and better public services; the poor benefited from all these things (Birdsall 2010). Moreover, the universal education, health, and social insurance programs that served the middle class also greatly supported the poor.

By contrast, the pro-poor focus that has shaped social protection systems in developing economies may have also undermined middle-class support for poverty reduction. A reliance on targeted benefits that exclude the nonpoor—while perhaps making sense in terms of fiscal or technical efficiency—do little to make these programs sustainable. Besley and Kanbur (1990) and Gelbach and Pritchett (2001), among others, argue that targeting to reduce fiscal costs and to reach the truly poor can be counterproductive if the programs as a result lose the political support of the middle class. Some advocate explicitly allowing "leakage" to the nonpoor as means of shoring up broader political support (Pritchett 2005). By contrast, in the richer nations, the universal education, health, and social insurance programs that served the middle class and that have been financed through taxation also served the poor.

Among the nonpoor there is often a widespread belief that poor households will misuse income transfers and that welfare creates dependency. Whether or not these are unfounded perceptions, they are very real in terms of influencing program design and survival (Harvey 2007; Holmes and Jackson 2007). Public opinion regarding antipoverty transfers can dramatically affect the durability of these programs. Evidence from Latin America, for example, shows that those countries whose citizens hold the poor responsible for their own poverty are less likely to support large antipoverty efforts (Graham 2002). Consequently, social policies that tie eligibility for receipt of transfers or investments in human capital are often designed to maintain legitimacy in the eyes of the public (Lindert, Skoufias, and Shapiro 2006).

Conditional cash-transfer (CCT) programs are a prime example. One argument in favor of conditionality—whatever the economic evidence—is that it may facilitate political support for transfers. Policymakers view CCTs as more politically acceptable to voters and taxpayers, since recipients are required, in complying with program rules, to engage in "good" behavior before they can receive cash. Conditionality also dilutes the negative (and often misguided) perceptions of welfare dependence, since association of social assistance with more broadly accepted investments in health and education enhances its attractiveness to voters (Samson, Mac Quene, and van Niekerk 2006).

But sometimes no amount of conditionality can overcome voters' dislike of pro-poor programs. For example, Nicaragua's CCT, Red de Protección Social (social protection network, or RPS) was financed with a loan from the Inter-American Development Bank (IDB), and several evaluations identified positive effects on poverty and inequality (Maluccio and Flores 2005; Fiszbein, Schady, and Ferreira 2009; Moore 2009). However, opposition politicians began to complain about RPS's administrative costs as well as the narrowness of its targeting. The incumbent government was defeated at the polls in 2007, around the same time that the RPS was not renewed (it was replaced by a number of other poverty reduction initiatives). The RPS lasted only for the life of the IDB loan through which it was financed.

Yet program designers in the developing world, appear to have moved even farther in the direction of pro-poor biases for social protection. And the consequence has been middle-class alienation from the idea of social protection.

With the expansion of noncontributory benefits that took place in Mexico in the last decade, the subsidy from formal sector workers to informal employment has increased. Levy estimates that, on average, taxes on low-skilled formal workers amount to 25 percent of their wage, and subsidies to informal workers are equivalent to 8 percent of their remuneration. Meanwhile, poorer workers tend to opt out of the formal sector because their valuation of formal social security benefits is lower—given, for example, the lower quantity and quality of services where poor workers live—while at the same time in the informal (and less productive) sector they can get similar benefits essentially free. The result is not merely an oversized informal, less productive, sector, in which poor workers are overrepresented, but a middle class that has grown increasingly frustrated with poor quality services.

In many low- and middle-income countries, the growing middle class has little stake in the de facto or de jure system of social protection. In the 2005-09 wave of the global World Values Survey, respondents around the world were asked, "Which of these problems do you consider the most serious in your own country?" Table 10-3 shows percentages, averaged by income quintile, of those who responded, "People living in poverty and in need." The table shows two stylized facts. First, poverty is a greater concern in poorer than in richer countries, but the gap varies. Only in Japan and Sweden, for example, do respondents uniformly pick another issue more pressing than domestic poverty (compared to over half of Germans and Australians surveyed). Second, the table shows that the gap in opinion between the first (poorest) quintile and other income groups is generally wider in low- and middle-income countries than in high-income OECD countries. There are exceptions: in Brazil and India, for example, poor and nonpoor alike appear to have similar views on the importance of domestic poverty (in fact, slightly larger percentages of the rich think that poverty is the most pressing problem compared to the poor). However, in other countries the gap between the richest and poorest quintile is large: in Ethiopia (15 percent), Zambia (25 percent), China (30 percent), and Rwanda (38 percent) poverty is a much greater concern among the poor than among the nonpoor.

Even India and China—where social protection is on the rise—have continued a highly targeted, fragmentary approach to social policy. In India various programs—and special measures within programs—have been put in place to reach different sets of the marginalized populations. The National Rural Employment Guarantee Act (NREGA) is, of course, a prime example: it guarantees a hundred days of public employment at a stipulated wage rate. The national Sarva Shikhsa Abhiyan (SSA) focuses on primary education for children of poor, rural families. The Rashtriya Swasthya Bima Yojana (RSBY) provides health insurance for individuals below the poverty line. And so on (see De Haan 2013). In each case, there is a specialized targeting mechanism built

Table 10-3. *Support for Poverty Reduction, by Income Quintile, Selected Countries*[a]

Percent

Country	*First*	*Second*	*Third*	*Fourth*	*Fifth*
Brazil	0.60	0.65	0.63	0.65	0.68
China	0.63	0.48	0.52	0.52	0.32
India	0.62	0.52	0.56	0.60	0.72
Ethiopia	0.67	0.40	0.40	0.37	0.51
Rwanda	0.78	0.71	0.72	0.46	0.40
South Africa	0.60	0.56	0.54	0.50	0.52
Zambia	0.78	0.75	0.65	0.52	0.53
Germany	0.50	0.51	0.46	0.42	0.41
Japan	0.06	0.12	0.10	0.07	0.10
Australia	0.54	0.52	0.51	0.48	0.51
Sweden	0.24	0.24	0.25	0.20	0.20

Source: World Values Survey (2008).

a. Figures are average percent of respondents choosing "People living in poverty and in need" as the "most serious problem" facing the country, grouped by within-country income quintiles, with first being the poorest, fifth being the richest.

into the distribution of benefits. Meanwhile, the Indian middle class, which perceives few benefits from these state programs (for example, labor-intensity requirements make it impossible to use NREGA funds to improve transport networks, electrification, food distribution, water or sanitation or other services from which the nonpoor could benefit), has withdrawn into its own privately funded world of utilities, health, and education (Subramanian 2013).

Chinese welfare shares many similarities with India. There are missing components, notably the dimension of family policy; but also missing is income security during illness and health care coverage for dependents, along with shortfalls in the implementation of even obligatory provisions. Meanwhile coordination between central and local authorities is limited (Ringen and Ngok 2013). Still, China has done somewhat better in engaging the middle class in its moves to expand social protection. Indeed, there is a clear government direction toward the expansion of public policies, as China moves to high-income status (De Haan and Shi 2012). China expects to build an integrated social security system, and expansion of the health system is under way. At the same time, government spending will likely remain tightly controlled, and there is a strong aversion to the welfare-dependency trap that is thought to afflict countries with larger welfare states (Lu and Feng 2008).

Special Considerations in Fragile States

Over the next two decades the share of the world's extreme poor who live in stable middle-income countries is expected to fall from 60 percent to approximately 30 percent (figure 10-6). By contrast, the percentage of the extreme poor who live in fragile states will increase from 35 percent to 55 percent (the remaining 15 percent will inhabit stable low-income countries). Consequently, much of the progress in achieving the last mile will have to occur in fragile states, most of these also being low-income countries.

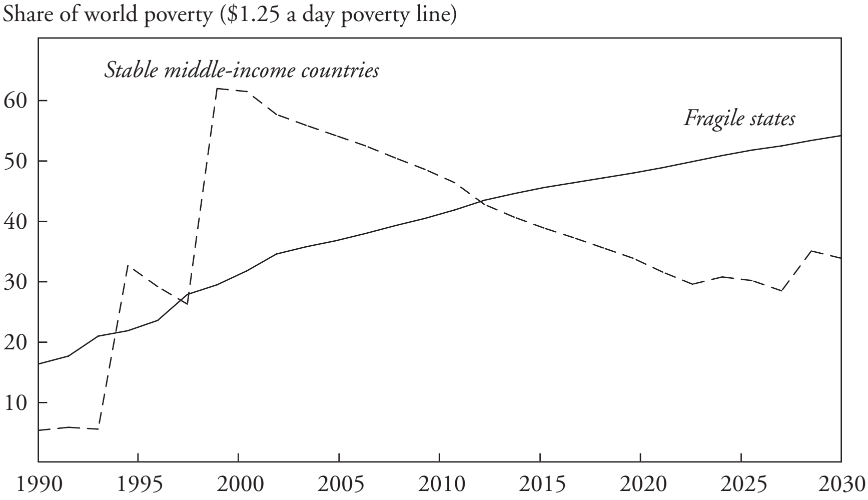
Fragile states face an unattainable triad with respect to the principal goals of social protection, namely, the eradication of extreme poverty, the avoidance of social tension, and cost effectiveness. Given that most fragile states suffer from significant ethnic, religious, or linguistic fractionalization and tension, highly targeted programs (assuming they are cost effective) may be vulnerable to elite capture or resource diversion. Moreover, where the poor are predominantly of a particular minority group, targeted programs can breed wider resentment among the majority. Consequently, social program designers are cautioned to rely, to the extent possible, on more universalistic programs in order to manage social conflicts. But this would raise concerns about cost effectiveness among donors. Were program designers to focus on cost effectiveness and social cohesion, it is possible that targeting would yield programs with significant undercoverage of the poorest groups. In other words, program designers can achieve two, but not all three, of the goals of social protection in fragile states.

The conventional approach by donors in low-income countries, then, is a combination of eradication of extreme poverty and cost effectiveness—that is, antipoverty programs targeted at the extreme poor. The objectives of these social programs are typically designed with concerns about sustainability in the face of severe resource and budgetary constraints and have very little to do with the imperatives of solidarity, citizenship, and nation building. In fragile states, however, these latter concerns should be paramount.

Social protection in weak states raises a host of complexities for governments and donors alike. Given weaknesses in rule-based delivery mechanisms in states rent by factionalism and conflict, the opportunities for program administrators to allocate resources on the basis of loyalty or other factors unrelated to need can abound. Depending on the peculiar lineages of community power relations, local governments may be more prone to capture (and consequently, less accountable) than the central government. Under these conditions, weaknesses in state institutions may simply shelter local elites, who use their position to overprovide essential services to themselves or their families—or to otherwise expropriate wealth (Bardhan and Mookherjee 2006).

Local elites use a number of mechanisms to divert resources from the poor—even predatory behavior. Community-based projects can create an

Figure 10-6. *Poverty and Fragility, Two Types of Countries, 1990–2030*



Source: Author's calculations based on Chandy, Ledlie, and Penciakova (2013).

adverse-selection effect wherein individuals likely to obtain leadership roles are precisely those who are able to extract rents (Gugerty and Kremer 2000), to convince donors that their motivations are based on the collective good of their community (Harrison 2002), and to create the façade of community participation (Conning and Kevane 2002). Thus social policies in weaker states often constitute "nothing other than new 'structures' with which [elites] can seek to establish an instrumentally profitable position within the existing structure of neo-patrimonialism" (Chabal and Daloz 1999). There is also evidence of discriminatory practices against minority groups among the poorest, raising the possibility that cleavages among the poor can be induced by social policy. Sri Lanka's Sumurdhi cash-transfer program, for example, once accounted for nearly 1.5 percent of GDP. Survey data indicate that the program discriminated against minorities as well as those in newer settlements (Gunatilaka 2000). In other words, in the hands of highly corrupt officials in states without adequate monitoring mechanisms, social protection can be a tool of oppression.

Moreover, evidence of the cost effectiveness of targeting in weak states is decidedly mixed. Given the extent to which effective targeting relies on information, targeted programs are more likely to suffer from inclusion error as well as higher relative administrative costs in states with fragile institutions. If government capacity is limited, then targeting may overburden the government's administrative resources, while at the same time be more prone to backlash.

Finally, technological innovations have the potential to minimize the cost of more universal programs. India's Unique IDentification Authority of India (UIDAI), which in 2010 launched the Aadhaar program to collect biometric identifying data of all 1.2 billion citizens, was designed in part to enable lower-cost (as well as fairer) access to social benefits and services and, ultimately, to provide entitlements directly to citizens (Daugman 2014). Adopting these innovations in fragile states could overcome resource constraints.

Can the scaling up of social protection in fragile states make similar progress in the last mile of ending extreme poverty? Social protection, when viewed restrictively, is sometimes considered distinct from programs aimed at alleviating extreme poverty. In developing countries, social protection was often traditionally associated with a set of institutions, policies, and programs aimed at providing benefits to individuals and households to enable them to cope with short-term risks. But there is now a greater consensus that social protection can provide an appropriate framework for addressing transient and chronic poverty in ways that should not be limited to addressing short-term vulnerabilities but that can also create conditions for the poor to escape from poverty (Barrientos, Hulme, and Shepherd 2005).

Conclusion

This chapter attempts to make three separate but related points regarding the role of social protection in eliminating extreme poverty. First, inclusive growth—that is, a favorable combination of income growth and inequality reduction—has diminishing effects on the elimination of extreme poverty past a certain threshold. Historical and contemporary evidence suggests that increases in labor incomes in several fast-growing countries have been responsible for the reduction in extreme poverty to approximately 15 percent of the population. Beyond this, reducing extreme poverty requires greater attention to social protection.

Second, the development of institutions of social protection has followed different trajectories in countries that industrialized before, or in the early years of, the twentieth century and in low- and middle-income countries. The latter countries lag in welfare-state development at levels of income comparable to the first group. The conditions under which systems of social protection were scaled up also differ between today's richer and poorer countries: conditions of increased global competition for capital, larger shares of workers in the informal economies, and due to tighter budget constraints, a more prominent focus on the need for targeted benefits. The result in low- and middle-income countries has been to fashion a fragmented set of ad hoc programs from which the non-poor are generally excluded.

Third, this exclusion may have consequences for the political sustainability of social protection efforts. In particular, a group that has historically proven to be pivotal in the scaling up and consolidation of social protection—the middle class—has been denied access to and representation in welfare state benefits and policies. This exclusion appears, here and there across the developing world, in the form of middle-class discontent with social policy and public services as well as in withdrawal into a world of private social insurance, health, and education.

The central obstacle, from this perspective, is not program designers' lack of knowledge, managerial skill, or fiscal resources to create social programs able to eliminate extreme poverty but rather that the domestic politics of developing countries will restrict the scale and duration of redistributive programs. The poor may face high collective action costs, limiting their agenda-setting power. The median voter may not support programs that transfer wealth to the poor. Politicians face strong incentives to use redistributive programs for partisan purposes, limiting the likelihood that these programs will survive political transitions or changes of government. And politicians and public officials may also be prone to create institutional mechanisms that enable them to target different programs to specific groups, potentially limiting their ability to expand in coverage and scale. These interactions between the poor, nonpoor, and public officials—as well as the deliberate political calculations involved in the supply and demand of antipoverty policies—can either limit the scaling up of antipoverty programs or render them unsustainable.

Last, it is also likely that systems of social protection capable of moving countries along the last mile will have to, as one author puts it, rebuild "cross-class solidarities" between the poor and the nonpoor (Deacon 2010). This may seem counterintuitive; after all, if the goal is to reduce the headcount of the extreme poor, why not refine and sharpen targeting mechanisms? This has been the approach of the donor community. But it ignores the need for well-functioning states in managing social protection, at the core of which are durable and accountable programs supported by all social groups. Such an approach would aim at moving from the common, disparate set of safety nets in place in developing countries toward a more comprehensive system that manages the risks and vulnerabilities faced by citizens.

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