UNRISD United Nations Research Institute for Social Development

CONFERENCE NEWS

Financing Social Policy

Report of the UNRISD International Workshop, 1–2 March 2007, Geneva

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Introduction

Social policy is a central instrument to promote an inclusive and democratically anchored development process. In recent years, the general perception of the costs and benefits of social policy has changed, and policy makers are increasingly aware of the positive potential social policy entails. Nevertheless, the challenge is to build social programmes on financial arrangements that are themselves sustainable, equitable and conducive to economic development.

The United Nations Research Institute for Social Development (UNRISD) initiated a project in 2006 to examine options and constraints for financing social policy in developing countries. The research, which is funded by the Ford Foundation, explores the developmental impact associated with specific financing techniques and revenue sources, the latter covering taxation, social insurance contributions, social and pension funds, mineral rents, remittances and aid. The project is situated within the UNRISD research programme *Social Policy and Development*, which takes a broad approach to social policy, defining the concept as going beyond basic protection and poverty reduction goals to impact on the productive, reproductive, distributive and protective spheres simultaneously.

UNRISD has commissioned 13 papers on the theme of financing social policy, and these were presented at a two-day workshop in Geneva on 1–2 March 2007.[1] This workshop, which brought together the commissioned researchers, as well as academics, government officials, representatives of donor agencies and experts from the United Nations, including staff from the International Labour Organization (ILO), the United Nations Conference on Trade and Development (UNCTAD) and the World Health Organization (WHO), was a forum for discussion of the outline of the project, and for identification of key research questions, cross-cutting issues and preliminary policy implications. During the second stage of the project, UNRISD plans to commission in-depth and comparative country case studies in different geographical regions on the six major revenue sources around which the project is framed.

In opening the workshop, UNRISD Director Thandika Mkandawire stressed the importance of learning from the experiences of successful cases in social policy. Previous work at UNRISD brought out the multiple roles of social policy, beyond the protective function

[1] Three of the 13 papers presented at the workshop were commissioned under the prior UNRISD research project, *Social Policy in a Development Context.*

emphasized in conventional debates. The central preoccupation of social policy in successful states has not been poverty reduction; rather, a whole range of social policy measures have been introduced at lower levels of the industrial development process. The issue of finance and social policy emerges repeatedly in the research on late industrializers, which inspired the design of this project. If they are to generate real solutions, Mkandawire argued, debates on social policy in developing contexts must engage the financial dimension. The UNRISD approach insists that financing social policy should be concerned not only with efficiency, but also with equity, social cohesion and inclusion, as well as the more conventionally recognized social policy functions.

In her opening remarks, Research Coordinator Katja Hujo outlined the background and main research issues being addressed by the project.

Project Background and Overview

A key lesson from the previous five-year research project *Social Policy in a Development Context* was that the dominant policy models of the past—populist/redistributive regimes based on soft monetary and fiscal policies, and liberal/conservative regimes based on austerity policies, privatization and downsizing of public welfare provisioning—have failed to provide a long-term strategy that is developmental, democratic and socially inclusive. One of the reasons for this lies in the fact that economic and social policy have to work in tandem in order to be mutually reinforcing. An integrated approach is based on the premise that social policy has multiple roles, which have to be balanced against each other. An unduly narrow focus on one role, be it redistribution or production, or the outright neglect of others (often gender equality and democratization), can endanger the political or economic viability of the policies, and certainly undermine their success in terms of social development.

Approaching the topic of financing social policy leads to questions of resource mobilization, resource allocation, and the actors and institutions involved in these processes. The current approach is dominated by a micro perspective on how best to allocate a given amount of resources. Although efficient allocation of resources for social policy is important, taken in isolation this perspective entails serious shortcomings: it sidelines the impact of welfare arrangements on economic development, and vice versa. However, what is crucial about social policy *in a development context* is to identify how such policy can actually support and enhance a dynamic accumulation process that allows for the creation of income, which can then be taxed and redistributed toward socially desirable ends.

Accounting for the developmental impact of social policy is even more important considering one of the central dilemmas confronting policy makers: the so-called affordability of public social expenditures. In general, public finance seeks to match revenues and expenditures in the medium term. However, in the case of prolonged economic stagnation, social transfers are quickly over-stretched. By going beyond demand stabilization and protection, the use of social transfers evolves into a quasi-permanent substitute for income building and the creation of formal employment. If this is the case, budgetary pressures and indebtedness tend to increase, and eventually constrain the fiscal and economic space for social policy—even if political commitment is in place. In developing countries with limited capacity for debt-financing, more commonly, the state either fails to deliver on entitlements to citizens or the insured, or it shifts part of the burden toward individuals, families and communities (for example, by increasing the amount of unpaid care work or out-of-pocket payments).

Debates surrounding the affordability of social policies have intensified in recent decades. Several trends contributing to this process can be identified. The first was the paradigm shift in the 1970s from the Keynesian welfare state model toward the liberal market model. One implication was that social policy was no longer seen as a central instrument for social development and stabilization, but increasingly as a cost factor and potential cause for fiscal crisis, inflation and market distortions. Additionally, demographic changes like ageing and lower fertility rates challenged social insurance schemes that were financed out of contributions from the active working population. Growing inequality, as well as unemployment or increased informal employment, put pressure on revenues and expenditures alike, whereas economic integration and liberalization of goods and capital markets increased competition in general, and more particularly tax competition.

Most industrialized countries are in the process of adjusting their tax/welfare regimes to meet these challenges (and they are usually well equipped to do so), while also trying to maintain their basic policy regime

or social contract. Developing countries, however, struggle more for a variety of reasons. They are confronted with a huge mismatch between means and ends: social investment and transfers are desperately needed, while state revenues and administrative capacities are limited. Institutional legacies are posing additional difficulties. Existing social protection schemes are often fragmented, stratified and regressive, and social contracts in support of redistribution are weak. Furthermore, adjustment and stabilization policies, plus balance of payments and currency crises, have increased volatility, income and asset concentration, external debt, budget deficits, unemployment and informal sector employment. And last but not least, Washington consensus policies (the triad of privatization, liberalization and deregulation) have frequently resulted in lower administrative capacity; declining revenues due to the substitution of difficult-to-collect taxes for easy-to-collect ones; high fiscal costs related to privatization policies; decreased domestic economic activity to tax; and subsidies or tax exemptions that are designed to attract foreign investors but squeeze fiscal revenues.

Growing criticism with regard to the theoretical underpinnings of these policy blueprints, together with ample empirical evidence on the development failures they produced, eventually fed into new debates that gradually extended to the global policy-making level. Key events like the World Summit for Social Development, the declaration of the Millennium Development Goals (MDGs), together with Bretton Woods initiatives such as debt relief for the poorest countries (HIPC) and poverty reduction strategies (PRSPs), illustrate the rising profile of social issues. The recognition that social policy has highly beneficial effects even in middle- or low-income countries, which were traditionally believed to be "too poor" to afford welfare policies, opens a window of opportunity for countries wanting to embark on such a strategy. Additionally, recent trends in global trade and international commodity prices, not to mention growing remittances and aid flows, have the potential to ease the financing constraints for some countries in the South, as long as macroeconomic stability can be safeguarded and governments show more willingness to upgrade their social agenda beyond poverty reduction and emergency measures.

In the light of these opportunities and constraints, various challenges emerge: to combine transformative social policy with employment-intensive development strategies; to go beyond the recommendations of the post–Washington consensus by stressing the importance of universal approaches, redistribution policies and the macro role of social policy; and to forge political and external coalitions in support of reforms.

In turning to possible guidelines for designing financing regimes for social policy in a development context, Hujo identified three criteria: basic normative principles, aspects of governance (implementation, capacity) and developmental impact. Moreover, choices between different options will be influenced by basic decisions regarding the desired balance of public versus private instruments, targeted versus universal schemes, the scope of solidarity and redistribution built into the system, and the type of care regime that is implicitly or explicitly chosen. The main question explored in the UNRISD research is whether different resources and financing techniques have diverse developmental and distributional impacts, and, specifically, their effect on (i) production and reproduction, (ii) protection and redistribution, and (iii) social inclusion and democratization. The research also takes into account the context of a country's social and economic policy regime, as well as historical trajectories.

With this basic framework in mind, Hujo outlined for participants the main areas being examined under the project.

- *Taxation reform*—The reform of tax systems in developing countries is one of the most important tasks regarding the financing of social policy. Taxation revenue is generally deemed superior to other sources in terms of stability, distributional justice and meeting the goal of universal coverage. Tax systems are also said to enhance ownership and state accountability. Whereas the goals of taxation reform seem to be widely accepted (increasing the volume of tax funds, enhancing their progressive structure and gender equality, and improving transparency and efficiency), past reforms implemented under the guidance of multilateral donors have been associated with some undesired outcomes, like shrinking state revenues or implementation failures.

- *Social insurance and coverage*—Is the extension of social insurance programmes a viable option for developing countries? Social insurance can be organized according to different models, such as public, private or occupation-

ally based insurance schemes, and pre-paid (funded) versus redistributive (pay-as-you-go) schemes. The challenge is to balance the goals of coverage, adequacy of benefits and financial sustainability, especially in developing countries with large informal sectors and high percentages of hard-to-cover groups.

- *Pension funds and development*—Pension funds have been a major financing source for investment in different countries, and in this sense they are a good example of how to combine the productive and protective roles of social policy (whereas pay-as-you-go systems constitute an example of how to combine social protection with social cohesion through forging a generational contract). Investment policies are crucial: high social returns are desirable from a developmental point of view, whereas profitable low-risk investments are necessary from a protective point of view. Privatization policies have performed poorly on both accounts, by imposing high transition costs on governments and substantial social costs in terms of coverage, uncertainty of benefits, greater gender inequality, etc.
- *Mineral rents and development*—Mineral-rich countries in the developing world frequently under-perform in terms of human development. Are resource-rich countries fortunate because they are wealthy, or do they suffer from a resource curse? How can the economic and political challenges associated with rents from mineral or other natural resources be managed? What are necessary external and internal preconditions? What lessons can be learned from successful cases?
- *Remittances and social development*—In a context where global capital flows are increasingly volatile and aid commitments lagging behind, the steady growth of global remittance flows has led to euphoria in academic and policy circles. Remittances are seen as stable, counter-cyclical development finance "from below", providing foreign exchange at the macro level and increasing income, consumption and investment for receiving households at the micro level. Yet problems associated with migration include brain drain, care drain, social disintegration, remittance dependency and "Dutch disease" effects. Questions therefore arise as to the impact remittances have on the different dimensions of social development, how they shape patterns of social provisioning and the implications they entail for social policy.
- *Aid and social policy*—International donors have agreed to substantially increase official development assistance (ODA) for low-income countries in order to accelerate the MDG process. Additional funding for poor countries can ease financial constraints, but like natural resource rents, increased aid flows pose a variety of political and economic challenges (related to condition-ality, accountability, Dutch disease effects), which have to be addressed successfully in order to make aid more effective for development.

In concluding her remarks, Hujo emphasized four points. First, social policy instruments should be based on principles of universality, solidarity, integration, efficiency and sustainability. Second, the financing mix is country-specific, and even low-income countries have achieved good social outcomes by dedicating above-average resources and efforts to social policy. Third, the processes and institutions involved in resource allocation are important with regard to human development outcomes. Finally, economic and social policy have to work synergistically at the micro and macro levels in order to advance societies' well-being.

Financing Social Policy: Challenges and Constraints

This research project is based on the view that financing social policies is especially challenging for developing countries, given the particular nature of the economic and institutional constraints they confront. The first two presentations laid the groundwork for a discussion of the predominant social policy models and reform trends, and their suitability for the developing world. The recurrent message of this discussion was the need for strong interlinkages between social and economic policies.

In his presentation, Rubén Lo Vuolo explored the limits and potential of current approaches to the problems of social exclusion in labour markets in Latin America. He made a staunch critique of the prevailing conceptual framework around social protection, elsewhere designated "social risk management",[2] as

illustrated by shortcomings in the areas of pension reform, workfare and microfinance programmes. Set against a backdrop of the failure of social liberalism, as articulated under the Washington consensus, to attend to the needs of vulnerable groups and segments of Latin American societies, social risk management has emerged as a revision of World Bank orthodoxy that attempts to reassert the dominance of the market while acknowledging a legitimate role for the state. The revision lies in a renewed emphasis on state institutions as requisite for reducing market instability, reinforcing competition and improving overall market functioning, ultimately aiding in the reduction of poverty. In essence, this approach retains the orthodox faith that economic growth will produce spillover effects by means of employment generation, while the state provides *social protection* to assist individuals in managing social risk. This protection is provided through a modular system of *safety net* programmes that are tailored to the specific risk patterns of different groups; these programmes are then expected to function according to a logic of *social insurance* that diversifies risk and stabilizes individual consumption and savings patterns.

According to Lo Vuolo, there are clear limits to the application of such mechanisms to a developing context such as that of Latin America. Not only do these policies fail to recognize the disproportionate effect of economic volatility on the poor, but they also overlook the direct link between economic volatility and the economic and social policies supported by the international financial institutions (IFIs). Furthermore, employment does not guarantee social security coverage for the very large numbers of informal, semiformal and temporary workers, or the working poor. In this sense, social risk management's emphasis on individual responsibility in determining one's position in the labour market is misplaced in these contexts; informality is not chosen by workers but rather is imposed by employers and the state. These shortcomings are made evident in three policy areas promoted by the World Bank: pension reform, workfare programmes and microfinance programmes. In general, these policies are characterized by incentives based on false premises (for example, where employment is assumed to be a problem to be solved by social policy when it is fundamentally a macroeconomic phenomenon), low coverage among the poor, a low impact on poverty due to selectivity and targeting, and unjustifiably high administrative costs. In the case of microfinance, poor people become indebted in exchange for access to impoverished markets, ultimately benefiting financial sectors instead of promoting higher incomes or savings.

Alternatives to the social risk management framework—such as the Employer of Last Resort (ELR), and the Renda Básica de Cidadania (Basic Citizenship Income) in Brazil—have advantages and disadvantages when applied to the Latin American context, explained Lo Vuolo. Proponents of the ELR propose an economic model in which the state offers remunerated employment for anyone seeking it. By emphasizing the role of the state in job creation, this approach questions the minimialist view of the state put forth in the orthodox macroeconomic framework. The Renda Basica, implemented in Brazil in 2005, directly addresses poverty through an explicit legal change in income transfer policies. Nevertheless, it struggles to reconcile the principle of universality with implementation mechanisms and technologies that are rooted in a tradition of targeting, not to mention the fact that the programme lacks a sustainable financing source. On balance, these alternatives make important strides, on the one hand by encouraging policy makers to rethink the proper role of the state in the economy vis-à-vis employment, and on the other, by vindicating universal and unconditional social policies.

Lo Vuolo concluded his remarks by emphasizing the need to advance toward the construction of a universalistic social protection system, one that is based not on "one" policy, but rather on a "system of consistently articulated policies". These policies should place formal employment at the centre of the problem and, more importantly, recognize that unemployment is a pathology of economic, not social, policy. In particular, social policies should be *preventive* and *proactive* in nature, not reactive or emergency responses; furthermore, they should aim at consolidating long-term support for universalism and unconditionality. Policies that emerge from the prevailing social risk management discourse may seem revisionist at first glance, but ultimately, they retain fundamentally flawed elements of the orthodoxy.

Enrique Delamonica and Santosh Mehrotra followed with a presentation on "pro-poor" financing of social services. Echoing Lo Vuolo's point that good social policies are those rooted in a system of consistently

[2] Robert Holzman and Steen Jorgensen (2000). *Social Risk Management: A New Conceptual Framework for Social Protection and Beyond.* Social Protection Discussion Paper 0006. World Bank, Washington, DC.

articulated policies, Delamonica introduced a framework for analysing pro-poor services based on a set of interrelated synergies at the macro level. Economic growth, poverty reduction, reproductive labour and social development are all interdependent and should reinforce each other to produce positive human development outcomes. If it is true that economic growth depends on sound macroeconomic policies, and technological and structural change, it likewise depends on social policy, income poverty reduction and reproductive labour. In the same way, both income poverty reduction and social development cannot be sustained without economic growth working in tandem with socially oriented, gender-sensitive redistributive social policies. In turn, achieving these pro-poor outcomes requires an understanding of the "complex fiscal causalities" involved. Just as social policy has multiple roles, the multiple roles of fiscal policy—including income distribution, output and employment, and social services delivery—should not be overlooked.

In the quest to achieve pro-poor social services, the choice of financing mechanism matters. Social service financing can be broadly classified into the following categories: self-provision (where the state is absent and households or individuals must carry the burden); user fees; pre-paid schemes and generalized insurance; earmarked taxes; indirect taxes; and direct taxes. These mechanisms can be assessed according to two criteria: the degree of *progressivity* versus *regressivity*; and the extent to which they are rooted in *solidarity-based* versus *individualistic* principles.

Weighing the different financing tools against these two criteria yields instructive results. At one extreme, the most regressive and individualistic financing mechanism is, not surprisingly, self-provision, while direct taxation emerges as the most progressive and solidarity-based of the mechanisms. User fees are widely criticized for being detrimental to the poor and, in fact, have largely been reversed since the 1990s. Generalized insurance based on pre-paid contributions poses an alternative to user fees that spreads risks and lowers costs, but high degrees of market segmentation (and regressivity in cases where insurance markets are not income differentiated) make contributory programmes less pro-poor. As concerns taxation mechanisms, indirect taxes such as the heavily-promoted value-added tax (VAT) are notoriously regressive and, insofar as consumption patterns vary according to gender, are also gender biased. Earmarked taxes, on the other hand, tend to be criticized on the basis of fungibility arguments (whereby general tax funds are diverted away from social services), but they actually have the potential to address gender bias and to be quite progressive, if one considers the possibility of luxury taxes or taxes on second homes. Finally, direct taxes (such as income or property taxes), though the most progressive and solidarity-based, are plagued with implementation challenges since they spark high levels of political resistance and are costly to enforce.

In reference to the political aspects of financing mechanisms, Mehrotra highlighted the fact that *governance* is key to improving the effective utilization of funds for the poor. Not only are Type I (leakage) and Type II (undercoverage) errors pervasive in targeted programmes for social services in developing countries, but the contractual basis for many of these services is an invitation to corruption. Evidence of "grand larceny" by public officials in programmes that are ostensibly for the poor cannot be ignored; but at the same time, social audits and transparency initiatives (such as the Right to Information Act in India) can, paradoxically, decrease support for social programmes among the rich, who are reluctant to back government policies plagued with corruption and targeting errors.

Overall, for the financing of social services to be more pro-poor, there must first be a shift in focus from expenditure-side policies to revenue generation. The tendency to advocate more regressive taxation mechanisms simply because they are easier to implement sidesteps deeper political and technical challenges which, if properly addressed, would pave the way for longer-term, more sustainable, and more equitable financing systems.

Hujo commented that both presentations took up important theoretical debates and presented alternative approaches. Lo Vuolo's remarks were innovative, offering a strong critique of a revised orthodoxy that is only just beginning to emerge in policy circles. Indeed, critical research requires overcoming the time lag commonly associated with sifting through illusory revisionist discourse in order to pose alternatives "in the moment". The alternatives such as the ELR and the Renda Básica raise important issues—the ELR establishes work as a right rather than an emergency response; and the Renda Básica demonstrates the common disconnect between formal rights and implementation that characterizes the Latin American context.

In their presentation, Delamonica and Mehrotra offered a good classification of the various financing instruments to help frame further research on the "social contract" behind sustainable and equitable financing regimes. In this vein, their focus on synergies was especially relevant, bearing in mind that particular institutional mixes display path dependencies. An understanding of the institutional complementarities within "varieties of capitalism" that produce the most equitable and sustainable outcomes is crucial, and speaks directly to concerns about the political feasibility of redistribution in the developing world.

One participant acknowledged the theoretical superiority of direct taxation, but noted the extreme difficulties confronting developing countries that wish to implement tax reform in the face of enormous informal sectors, not to mention high degrees of uncertainty and unpredictability of income levels. Determining whom (individuals or households?) and what (income or assets?) to tax is paramount. In response, Mehrotra pointed out that precisely because informality is so pervasive in developing countries, more attention should be paid to proposals, such as the one recently presented in India, that would foster social insurance systems in the informal sector.

Furthermore, even in developing countries, the potential for direct taxation is not being reached. Existing tax collection methods are inefficient, but instead of improving technological capacity (for example, computerization can immensely improve countries' tax take at a relatively low cost), policy makers and donors alike simply push for regressive, but easy-to-collect taxes. In fact, it is not difficult to devise criteria that identify potential taxes that would be progressive in nature—ownership and use of cars or mobile phones, or airline travel, for example. Lo Vuolo reinforced this point by attacking the IFIs' contradictory uses of the "state capacity" argument. The emphasis on targeting in social policies conflicts with the support of regressive tax instruments: how is a state expected to have the capacity to target 60 per cent of its population (the poor), while it is assumed that it lacks the capacity to tax 20 per cent (the rich) with a progressive tax system? These arguments reveal gaping holes in orthodox logic.

Taxation and Aid

Building on the discussion of constraints and challenges for financing social policy in developing countries, the second session delved more deeply into the topics of taxation and aid, drawing primarily on evidence from low-income countries. Among other issues, the two presentations considered the implications of aid and other forms of external resource dependence (for example, commodity-based taxes) for developing countries' own capacities not only to finance and implement social policies, but also to diversify their resource bases.

In her presentation, Alice Sindzingre explored the conditions and constraints stemming from the finance regime that hinder the contribution of social policies to development in low-income countries. She concentrated on sub-Saharan Africa. While the principal constraints can be traced to processes of state formation and the historical structure of the tax regime in a given country, several additional factors compound the challenges facing low-income countries.

First, traditional dependence on commodities and trade-based taxation (in some cases representing upwards of one-third of government revenues) implies a high degree of volatility in revenue generation, impeding sound fiscal planning that would be based on predictable inflows. Second, external determinants like trade liberalization and foreign aid also have implications for tax systems. Given the historical dependence of low-income countries on trade taxes, trade liberalization severely aggravates existing revenue collection, eroding fiscal resources without putting in place sustainable alternatives. Studies by the International Monetary Fund (IMF) show mixed results for the recovery of lost trade revenues, but the positive trends largely reflect gains in middle-income countries from the implementation of the VAT. In contrast, low-income countries, by and large, have not enjoyed revenue gains from the VAT due to problems with the refund and credit mechanisms, underpayment and high levels of informality.

Additionally, the nature of poverty reduction programmes themselves has been detrimental to low-income states' ability to finance developmental social policies, as social spending requirements can keep states from investing in productive sectors given the tradeoffs low-income countries permanently face due to budget constraints. It is important to note here that the composition and efficiency of social spending, not the levels *per se*, matter most. Many social programmes are also donor-financed and targeted in nature, which pose additional challenges for constructing developmental social policy systems. Finally, dependence on foreign aid makes states vulnerable to aid fluctuations and cre-

ates a disincentive for states to tax their own citizens. Consequently, the nexus of political accountability shifts from citizens to donors: as policies are perceived to be handed down from external actors, the credibility of governments and political institutions vis-à-vis citizens is constantly called into question.

Developmental states in Asia hold important lessons for low-income countries in terms of the political economy of taxation. One of the most important is that it is not the level of taxation ratios that matters, since many of the developmental Asian states exhibited relatively low levels of taxation. Rather, growth-oriented policies, complemented by heavy investment in education, secured a place for social policies that contributed to economic growth while simultaneously ensuring political legitimacy. Indeed, low-income countries get caught in a "taxation trap", wherein low levels of taxation, redistribution and low-level social services are locked into a vicious cycle, and as a consequence, political legitimacy is entirely de-linked from social policy. While there is no doubt that the Asian developmental experiences are instructive in a number of ways, their experiences result from a particular set of historical, political and economic processes that may or may not apply to low-income country contexts.

Oliver Morrissey followed with a presentation that examined the role aid plays in increasing financing for public spending on social service delivery in developing countries. The primary justification for foreign aid, and one that is often overlooked, is its role in the provision of public goods in the form of social services. Because there are international "spillover ranges" (positive externalities) associated with the provision of social services in low-income countries (and, conversely, negative spillover effects when these services are underprovided), the international community has an interest in "picking up the slack" where national government efforts fall short. The principle instrument through which these international public goods are provided is foreign aid, which may or may not work in tandem with national government social spending.

For this reason, there is a premium on providing evidence that aid in fact does work through national governments to positively impact on welfare outcomes. In fact, when changes in government social spending (understood to be expenditures on health, education and sanitation) are measured as a function of variations in aid flows, tax revenue as a share of GDP, and GDP per capita over a given period, foreign aid shows, on average, a small but significant effect on government social spending (which increases by 1.7 per cent for every 10 per cent increase in aid).[3] The effect of tax revenue on increases on social spending, however, is significantly larger, at 3.2 per cent. Aid has a greater impact on social spending in low-income countries than in middle-income countries, not only because middle-income countries tend to spend more, on average, on social services regardless of aid or tax revenues, but also because aid to middle-income countries is more likely to go toward investments in infrastructure.

Besides impacting on government social spending, aid also affects measures of aggregate welfare. These effects work through three primary mechanisms. First, aid can influence welfare directly, either by creating income-earning opportunities or through the direct provision of social services. Second, aid can improve aggregate welfare indirectly over the long run, by contributing to economic growth. Finally, as mentioned, aid can work through governments, increasing expenditures on social services which, in turn, impact positively on welfare indicators. There is robust evidence that aid does indeed pass through government social spending to reduce poverty and improve human welfare. Again, the effects on human development indicators are more pronounced in low-income countries; however, government social spending is less likely to impact on aggregate welfare in these same countries. Only in middle-income countries can the positive impact on aggregate welfare be fairly attributed to increases in government social spending. One of the reasons for the disconnect between increasing social spending through aid and aggregate welfare improvements in low-income countries is the low quality of public services. Not only are funds often misused or misallocated, but overall social spending tends to remain stubbornly low, despite having grown in recent years. It is likely that any positive effects of aid increases on welfare in poor countries occur primarily through direct impacts on growth, or through aid-financed programmes that tend to bypass governments altogether.

Aid does contribute to poverty reduction, through growth, direct benefits and support to social sector spending, but the effects are small, mainly due to the lack of effectiveness in social sector spending. However,

[3] Based on a sample of over 100 countries from 1980 to 2000.

there is no basis for recommendations that would double aid; rather, more attention should be paid to the effectiveness of government spending, since increasing proportions of aid flows do pass through budgets. There are concerns about the macroeconomic effects of rapid increases in aid, such as effects on prices, competitiveness (through pressures on foreign exchange) and general challenges for disbursement, but these are not insurmountable.

In his comments, Mkandawire noted that taxation is an intrinsic dimension of the state and a manifestation of the social contract, itself a concept that calls for further analysis. It is important to recognize the wide diversity in tax structures and levels, even across countries of similar incomes, which suggests that even developing countries have significant room for manoeuvre in the area of taxation. It may be true that developmental states are characterized by low taxation and expenditure levels, but in most cases, the tax system structures private incentives in such a way as to effectively *regulate* private consumption patterns. How states direct private expenditures to achieve positive social outcomes should be part of any debate on taxation. In developing countries, tax reforms have been aimed at building credibility to attract investment, but a distinction must be made between short-term, speculative portfolio investment (less desirable) and fixed, direct investment (more desirable). It is far from clear whether the tax incentives embedded in recent reforms were aimed at desirable creditors.

Furthermore, the analytical separation of taxation, aid and expenditure debates overlooks the *endogenous* nature of tax revenue in relation to both aid and expenditure. Not only do expenditure patterns reflect the tax structure in many cases, but aid inevitably influences the structure and levels of taxation, which in turn have an effect on expenditures. Uncovering the relationship between tax regimes and welfare outcomes involves disaggregating types of taxes and introducing new analytical tools (for example, the progressivity scale of tax mechanisms). The reason that the positive effect of aid on social spending is so small may well be due to regressive impacts of aid on the tax system, whereby the positive and negative impacts cancel each other out. Several participants endorsed this view and pointed out that quantitative debates about the impact of aid are misleading because they fail to address the more fundamental counterfactual: what would tax and expenditure structures have looked like in the absence of aid dependence? In the end, aid dependence undermines domestic policy space, severing debate around the key distributional questions on which consensus is based. Arguably, this effect is more damaging than any beneficial effect aid may or may not have on any social indicators. Finally, the concerns about the qualitative aspects of aid that stem from conditionality are underscored by the fact that there is more conditionality now than ever before.

Remittances and Social Development

In light of increasing flows of remittances and renewed interest in their potential to contribute to development, the UNRISD research in this area represents an attempt to problematize the potential relationship between social policy and international financial flows between migrants and recipients in sending countries. While the presentations clarified the relationship between remittances and social development, the discussion pointed to the inherent difficulties of integrating private flows of money into the financing social policy framework. Most participants agreed that remittances cannot be a substitute for social policy; they can merely act as a complement.

Discussion centred primarily on the presentation by Hein de Haas, although Christiane Kuptsch opened the session on remittances by briefly summarizing the main points of Manuel Orozco's paper on *Remittances and Social Development: The Latin American Experience*, since he was unable to attend the workshop. Orozco's work offers new data based largely on surveys that he has conducted in various Latin American countries, and contributes substantially to the debate on the relationship between social development and migrants' remittances. In his paper, Orozco presents a direct and systematic discussion that leaves few questions regarding "what the data say" about remittances and their potential use for social development in the region. The paper substantiates the claim that remittances are indeed used for social protection, as recipients use them to invest in nutrition, health and education. But remittances also act as social protection in times of economic downturn or crisis as well as during natural disasters, as evidenced by case studies examining the use of remittances in the aftermath of Hurricane Stan in Guatemala in 2005 and during the banking crisis in the Dominican Republic in 2002. The relationship

between remittances and the local economy, particularly with respect to the extent to which local businesses cater to recipients of remittances to take advantage of these flows, is another point the paper raises. Finally, it puts forth a set of policy recommendations that would facilitate the leveraging of remittances for broader social uses, such as education and health care.

Hein de Haas's presentation addressed the key theoretical questions that emerge when analysing the developmental potential of remittances. Remittances have increased by a factor of 2.5 over the last decade; they now far surpass official development assistance and nearly match foreign direct investment in developing countries. In the face of a surge in international recognition of their potential as bottom-up, North-South financial tools for development, in many policy circles remittances have earned the label "the new development mantra" (even if Devesh Kapur coined the term somewhat dismissively[4]). Although there is theoretical interest in separating out the impacts of remittances from those of migration more generally, the fact is that remittances are the most tangible tool with which to analyse these effects. Consequently, there tends to be a one-sided focus on the impact of remittances on incomes, such that policies are aimed at facilitating and directing remittances into formal channels. In reality, migrants have multifaceted effects on development in countries of origin, such as changes in delivery of health or education, political debates, culture and the position of women in society, among others. These impacts tend to be neglected when discussions focus too narrowly on remittances.

Current insights into the impacts of remittances on development reveal the need for tempered approaches in order to balance the traditionally opposed views of "migration optimists" and "migration pessimists". Too much optimism about the potential of remittances to remediate structural developmental constraints is premature and misleading since evidence is often mixed or highly context-dependent, and assessments of the effects can be heavily value-laden. With respect to the protective dimension of remittances, most studies, including Orozco's, confirm the importance of co-insurance and risk-spreading functions among recipients. As for the effects of remittances on poverty, there is general agreement that, in the aggregate, remittances reduce poverty,[5] but the conclusions will vary depending on the level of analysis chosen. The same goes for inequality: comparisons across recipient and non-recipient households may reveal inequalities that trace back to the inherent selectivity of migration, but a cross-regional analysis may show remittances to have an equalizing effect.

In turn, debates about remittance expenditure by recipients tend to be misleading since they place too much importance on "conspicuous consumption" versus "productive investment". The fact that household incomes are fungible precludes drawing conclusions about how remittances, as compared with other sources of income, are spent. Likewise, determining which types of investment are "productive" is ultimately a subjective exercise, and one that ignores the role of the structural and institutional environment in enabling such investment in the first place. Studies that refer to the "disruptive" effect of migration on communities and care arrangements are similarly value-laden, and miss the more important point that migration almost always implies a trade-off. Similarly, debates about "brain drain" versus "brain gain" often fail to disaggregate by type of migration (for example, low-skilled or high-skilled), when in fact both processes occur simultaneously. Finally, with respect to broader political and economic effects, there is evidence that the power of so-called diaspora communities influences public debate in sending countries, and remittances can impact on economic growth at the national level, although the evidence is mixed.

What are the policy options for harnessing remittances for social development? In fact, the margin for manoeuvre for states is quite small and ideally begins with a set of general policies designed to restore migrant trust in the political and economic futures of their countries of origin. More specifically, though, de Haas proposed three sets of policy recommendations: those that would facilitate remittance transfers (which include improving banking and money transfer programmes, recognizing that cracking down on informal channels is likely a misuse of funds that could go toward improving formal channels); those that would create more legal channels for both high- and low-skilled

4 Devesh Kapur (2005). "Remittances: The new development mantra?" In S.M. Maimbo and D. Ratha, *Remittances: Development Impact and Future Prospects*, World Bank, Washington, DC.

5 Richard H. Adams, Jr. and John Page (2005). "The impact of international migration and remittances on poverty". *World Development*, Vol. 33, No.10.

migrants; and those that would recognize migrants as citizens. That said, focusing too much attention on the "positive" impacts of remittances paradoxically distracts from deeper political and economic issues, namely, the failure of the state to provide basic public services and ensure functioning markets. Policies aimed at maximizing the developmental potential of remittances are bound to have negligible effects if they are not accompanied by more general processes of political or economic change.

In her comments, Parvati Raghuram noted that the two papers complemented each other well, as one provides a thorough theoretical overview while the other offers empirical evidence. She suggested that two dimensions were notably absent from the discussions: class and cultural differences. How does class shape remittances? Often, what happens to remittances in countries of origin is dependent on the class or skill-level of migrants. Cultural factors can also influence expenditure patterns associated with remittances, as well as the levels themselves. Recognizing that household income is fungible, and that parcelling out the uses of remittances from other sources of income is difficult, there nevertheless may be ways to compare remittance-recipient households with non-recipient households. Furthermore, the rights of migrants did not figure into the discussion. Many countries have actually withdrawn migrants' rights, so merely assuming that the social burden of migrants would be transferred to recipient countries avoids deeper problems. Several participants also raised concerns about the relationship between social policy and brain drain, noting significant costs to developing countries when educated or highly skilled migrants leave and earn money abroad.

Perhaps most notably, some participants challenged the inclusion of remittances alongside the other revenue sources in the project, given that they represent private financial flows between people. Incorporating them into a social policy framework, therefore, could be less about the potential for the state to "capture" remittances, and more about the impact that remittance flows have on the provision of public goods. They not only help structure the demand for social services in communities, but in turn, remittance flows help determine how the state allocates its resources. One example of these interactions is the connection between remittances and pensions. Often, migrants do not return to their home countries precisely because they would lose the benefits they have accumulated in the receiving country. In this vein, one participant also noted the possibility of emulating existing schemes that enable expatriates to contribute to pensions in their countries of origin.

De Haas responded to these concerns by emphasizing the mixed evidence on migration and its impacts. While some things, such as the contribution of remittances to increases in income, are relatively clear-cut, conflicting evidence precludes broad conclusions about social development. The extent to which remittances can and do contribute to improved welfare depends on the institutional environment of particular countries. Nevertheless, it is more appropriate to talk about remittances and social *development*, than remittances and social *policy*, since the latter implies "tapping" remittances and assumes (rather paternalistically) that states know better than individuals how to use the income for welfare improvement. Remittances, if anything, are an investment in social security in the household, which is an appropriate point of departure for investigating the linkages in terms of financing social policy.

Mineral Rents and Social Development

For many developing countries, natural resource rents represent a substantial and growing proportion of total government revenues with potentially enormous implications for the design and delivery of social policies. Two presentations, one by Andrew Rosser and the other by Erling Holmøy, set out to link the debate on the alleged "resource curse" with discussions of the political, economic and social conditions necessary for overcoming the challenges posed by natural resource abundance. Avoiding Dutch disease and other manifestations of the resource curse is very context-dependent, and in the light of the diversity of experiences, the UNRISD research is most concerned with the role that social policies can and do play in this process.

Rosser began his presentation with a critical evaluation of the evidence pointing to the resource curse, and then examined the conditions under which the resource curse can be overcome. Briefly, the resource curse thesis is based on a correlation between the abundance of natural resources—especially oil—on the one hand, and a set of negative economic, political and social outcomes, on the other. Most commonly, scholars point

to the fact that countries rich in natural resources tend to have lower levels of economic growth and are more likely to be authoritarian. A smaller but substantial sub-literature examines the association between natural resources and higher levels of poverty or other negative social development outcomes, and one study in particular argues that natural resource wealth is associated with a lower status of women in society. Finally, a sizeable literature explores the relationship between natural resource abundance and the incidence, duration and intensity of civil war.

While much of this literature is persuasive, it is far from conclusive and should therefore be treated with caution. Several serious critiques have been levied against the resource curse thesis, attacking the prevailing evaluation methodologies on the basis of measurement errors, incorrect specification of the models, and the high probability of spurious correlations. For instance, the findings do not appear to be robust across different measures of natural resource abundance. The predominant measures of resource abundance are based on natural resource exports, but causal mechanisms suggest that the problem is not the volume of natural resource exports, but rather the *rents* from these resources. When measures of rents are used, the relationship is much weaker and is often not significant. Second, it is far from clear whether the type of resource matters, and if so, which resources (for example, point-source, lootable, etc.) are "cursed". Third, there are several studies that call into question the fundamental claim that there is a relationship between natural resource abundance, and negative economic and other indicators. Finally, from a purely methodological perspective, most studies on the resource curse are multiple regressions, statistical studies that draw broad-brush causal conclusions based on what could be mere spurious correlations. Any number of alternative explanations (missing variables, for example), other than natural resource abundance, could explain the outcomes in question.

Putting aside the debate about the existence of the resource curse itself, there are numerous examples of resource-abundant countries that do not suffer from resource curse "symptoms" (examples include Botswana, Chile, Indonesia and Malaysia, among others). Perhaps the more important question emerges out of the wide degree of variation in the developmental outcomes among these resource-rich countries: under what conditions is the resource curse overcome? Experiences of countries that have achieved both rapid economic growth and moderate levels of social development suggest that intervening variables—such as economic and social policies, or political institutions—can and do mediate the relationship between resource abundance and developmental outcomes. It is clear that different types of rentier states exhibit different incentive structures for elites, and these structures, in turn, are also determined by broader historical and structural factors, as well as the location of the countries in the global political economy. Massoud Karshenas later critiqued the literature on the resource curse precisely because it leaves us with more questions than answers regarding the conditions and causes. Every success case appears to be context-specific, but case studies are nevertheless instructive.

The Norwegian case, in which the resource curse was overcome through a unique combination of economic and social policies, is illustrative for many reasons. Holmøy offered key insights into the experience of the Norwegian Central Government Pension Fund (CPF) and how, after the discovery of large petroleum reserves in 1969, long-term planning, and careful investment and expenditure strategies, transformed Norway into one of the world's wealthiest countries on a per-capita basis. Specifically, Norway's success can be traced to five features of Norwegian political economy. First, the government savings ratio is high and has even been institutionalized in the form of a legal budget constraint whereby only the expected real return (4 per cent) of the CPF may be used to finance non-petroleum government budget deficits. This fiscal policy rule is a particular feature of the Norwegian system that has been surprisingly well-respected since its implementation in 2001. Second, Norway has strong institutions that ensure the protection of property rights, low levels of corruption, and a competent and accountable bureaucracy. In particular, the fact that the CPF is separate from the government budget, and is prohibited from being invested domestically, has all but eliminated incentives for rent seeking. Third, in this context, petroleum revenues have been instrumental in stimulating rapid economic growth, in large part through spillover effects leading to technological innovations in the petroleum sector. Fourth, some literature suggests that having a parliamentary (rather than presidential) system of government may facilitate Norway's management of natural resource wealth. Finally, Norway's early industrialization (prior to the Second World War) may have eased pressures to spend rapidly following the discovery of oil.

Norway's story, however, is much more than just a success story. Indeed, questions about the future economic sustainability of the pension fund, in the light of ever-increasing government entitlements and rising living standards, illustrates that a country's "development" is manifested via a never-ending renegotiation of the terms of its social contract. Holmøy's presentation also highlighted the sensitivity of resource-abundant political economies to fluctuations in commodity prices, and the close relationship between domestic taxation systems and natural resource revenue fluctuations. The outlook for the Norwegian CPF is drastically different when petroleum prices are estimated at $50 per barrel versus projections based on $25 per barrel, and the expected payroll taxes vary inversely with these prices. Whether the nature of the domestic taxation–commodity price nexus is similar for developing countries merits further exploration. Moreover, such complex model-based projections themselves require a great deal of technical expertise, which raises important questions about technical capacity as a necessary condition for weaving together the kinds of institutional complementarities between social and economic policies that characterize the Norwegian experience.

Karshenas commented that because discussions of social policy tend to be confused, the UNRISD framework, elaborated in the project *Social Policy in a Development Context,* has important implications for debates about oil economies. In the case of Norway, the social and economic conditions for success reflect a transformation of wealth from an exhaustible resource into permanent income by means of a fiscal rule tied to a particular kind of social policy—a pension fund. The question emerges as to which kinds of investments bring the highest rate of return for the country. When talking about social development, does investment in health or education within the country bring the same rate of return as investing the money abroad? In developing countries where social investments are notoriously inadequate, investment in social services could well offer social returns that rival any financial returns that come with other kinds of investments.

Moreover, several participants noted that the Norwegian experience also underscores the need to better understand the political conditions necessary to consolidate support for delaying the use of resource revenues for future benefit. In response, Holmøy emphasized the importance of efforts by the finance ministry to remind politicians of the consequences of breaking the fiscal rule. Interestingly, arguments that appeal to broad-based political constituencies like labour, which oppose the premature use of petroleum revenues because this would imply high transition costs (not the least of which would be a loss of manufacturing jobs), are also instrumental. Likewise, anti-inflationary monetary policy has become ingrained in the public mindset, so the argument that introducing petroleum revenues too quickly into the economy would be inflationary is quite effective. Another participant also noted the importance of strong inter- and intra-generational solidarity as a factor at play when passing difficult laws that bind generations. In response to the comment that natural resources are closely linked to fiscal policies, Rosser pointed out that while the budget process does have a role in shaping outcomes in developing countries, these also reflect larger political and economic forces that are mediated through the budget process.

Public Pensions, Social Insurance and Social Development

Social insurance schemes, such as public pensions and health care, take a variety of forms in both developing and industrialized countries. Two of the presentations in this session dealt with specific country experiences: Fred Hendricks discussed the South African pension system, and Ed Tamagno presented key points from his and Ken Battle's paper on Canadian pension reform. The third presentation, by Carmelo Mesa-Lago, explored the relationship between labour markets, social insurance (pensions and health) and coverage in Latin America. A common theme that ran through the discussions was the challenge of reconciling the necessity of financial sustainability in these schemes with the imperatives of ensuring coverage and adequate levels of benefits.

Hendricks's presentation accentuated the significance of historical legacies and the underlying societal divisions that have shaped the political economy of the South African social policy system. Pensions and pension reforms have played a central role in determining the availability of resources to finance social policies since the transition from apartheid. In an effort to protect their pensions in anticipation of what was assumed would be a redistributive democracy, public servants under apartheid converted the existing implicit debt of the pay-as-you-go system to an explicit debt of privatized, fully funded pensions comprised mainly of

government bond investments. In so doing, they effectively tied up resources for contributory pensions that could otherwise have gone toward social spending, infrastructural investment or development. Meanwhile, there is a direct correlation between the public debt and the immense and growing capital accumulation in the pension investment fund, but the fund is managed by a completely private entity—the Public Investment Corporation—that operates with virtually no public accountability.

Somewhat paradoxically, a positive defining feature of the overall pension scheme is a new policy of non-contributory benefits that now reaches some two million people and has had a significant effect on poverty. Democracy, for its part, did not necessarily usher in a wave of redistribution or a reversal of the newly acquired public debt in pensions as the reformers had feared. Instead, among other things it brought with it a Black Economic Empowerment movement that has fallen far short of addressing the deeply entrenched problems of inequality, poverty and unemployment. The fact that these stubborn structural divisions shake down along racial lines only exacerbates problems that come with devising equitable social policies in the South African context.

Canada, on the other hand, underwent a successful reform of its public pension system in 1997 in order to confront dire actuarial projections. Tamagno described Canada's adaptation to the realities of an ageing society via the introduction of landmark changes to how its "first pillar" mandatory public pension system, known as the Canada Pension Plan, is financed. Two features of the Canadian reform are instructive. On the one hand, it represents a unique case of public willingness to accept a slight reduction in benefits and an increase in the contribution rate in order to mitigate the system's financial burden and make it sustainable for future generations. On the other hand, it attests to the feasibility of incremental and relatively low-cost changes, rather than drastic, "all-or-nothing" replacements of defined-benefit programmes with privately administered defined-contribution schemes, to address the problems that come with population ageing.

The original design of the Canada Pension Plan dated back to 1966 and was financed on a pay-as-you-go basis, maintaining a small reserve fund that equalled two years of the costs of benefits and administration. By 1995, however, the actuarial forecast that had originally predicted a 5.5 per cent contribution rate for the year 2030, was forecasting well over twice this rate for the same year, at 14.2 per cent. The increase was due to a combination of demographic changes, expansions of benefits and economic changes. Since reform was imperative, it was necessary to build broad consensus around not only the need for reform, but the design of the package itself. The new strategy consisted of a near doubling of contribution rates to 9.9 per cent, and a modest benefit reduction. Perhaps most importantly from the financing perspective was the creation of the Canada Pension Plan Investment Board, an independent agency charged with implementing an investment policy that directs the investment of a larger reserve fund (equal to five years' costs) in high-return assets such as equities. The resulting scheme essentially keeps the contribution rate constant indefinitely.

There is a stark contrast between Canada's successful pension reform and the persistent problems of undercoverage in health and pensions in Latin America. Mesa-Lago delivered a thorough analysis of the current state of social insurance in the context of high degrees of labour market transformation in Latin America. Although there are significant differences in coverage rates between so-called "pioneer" countries and those with less developed welfare systems, increasing informality and labour flexibilization, along with reforms to the health and pension sectors, have contributed to declining rates of coverage in the entire region over recent years. Incorporating "difficult-to-cover" groups from the informal and rural sectors into the pension and health insurance schemes continues to be the key challenge. Indeed, the uninsured informal sector has actually expanded and now averages 47 per cent of the urban labour force for the whole region.

As was the case with South African social policies, Latin American social insurance coverage, besides being low, is highly unequal. These inequalities are largely explained by such factors as income level, gender, geographic location and ethnicity. Not surprisingly, populations showing the lowest rates of coverage tend to be low-income, female, rural and indigenous. Furthermore, coverage of the poor through social assistance, and the elderly through social insurance, also poses challenges in the light of recent reforms. Many of the poorest countries lack social assistance pensions altogether, and over the last decade the IFIs have neglected the poverty reduction dimension of pensions by heavily emphasizing the mandatory private savings pillar over the public pillar

in pension reform. Most of these negative trends can be traced to a combination of several factors external to the pension system itself (including high poverty and unemployment, low government commitment to social policy and scarce fiscal resources) with the failure of social insurance systems rooted in formal employment schemes to adapt to increasing segmentation, informalization and flexibilization in the labour market.

Huck-ju Kwon followed with comments that addressed common themes from all three presentations. Pensions have two developmental purposes, the most obvious of which is the income replacement function that directs the flow of money from the present to the future. However, the accumulation of reserves in the present allows for the use of pension-related resources for alternative developmental purposes. The cases of Canada and South Africa highlight important contrasts with regard to the management of public pension systems in these countries. In South Africa, the reserve capacity is enormous but the "developmental purpose" is lacking, and the fund is in essence artificial and unaccountable to the public. In Canada, on the other hand, the reserve fund is directed explicitly toward meeting the costs associated with providing pensions to an ageing society (a way of contributing to future economic development), and the investment board ensures credibility in the eyes of the public.

In the Latin American story, Kwon remarked, although the state was conspicuously absent from the presentation, it is (presumably) ultimately responsible for managing pensions and determining their developmental purpose. Indeed, Mesa-Lago's policy recommendation that pensions be targeted or means-tested in order to reach the most vulnerable groups brings the discussion back to debates over the desirable characteristics of social policies for developmental purposes. This recommendation was based on arguments of affordability and low state capacity, but some participants challenged the way the question of targeting versus universalism was cast in finding solutions to coverage challenges in Latin America. Perhaps it is more fitting to frame universalism as a desirable—but still unattainable—goal that could eventually be achieved by sequencing measures toward universal coverage in the future. As these cases clearly show, the very form that pensions (and other social policies) take is a manifestation of the priorities and implementation capacities of states.

Pension Funds and Development

This session focused on the challenge of reconciling the trade-offs—and maximizing the benefits—implied in the protective and productive functions of these kinds of social security systems. These themes carried over from the previous session but were specifically applied to pension and provident funds, emphasizing their role in national economic development in selected countries. The cases highlighted the importance of striking the delicate balance between the technical challenges of designing pensions, and the political challenges involved in aligning diverse interests in support of pension reforms.

In his presentation, Mukul Asher gave an overview of social security systems in several Asian countries, including India, Indonesia, Malaysia, Sri Lanka and Thailand. Any social security system must fulfil certain objectives for both governments and individuals: smoothing consumption over the lifetime; providing insurance, especially in contexts of longevity and inflation; redistributing income; and relieving poverty. However, given fiscal constraints, these objectives must be traded off against other needs such as economic growth, labour market efficiency, health care, education and infrastructure. The trend rate of economic growth is the most important determinant of the ability of a social security system to meet any of these economic security objectives. Because social security reform is a long-term process, sometimes spanning over a decade, the importance of sequencing and scalability also cannot be overlooked.

Within this reform process, organizational effectiveness and policy design are two critical factors for achieving effective reform. There are countless examples of poorly designed systems in Asia, but Thailand stands out with a defined-benefit scheme that is managed through the finance ministry. The minister of finance has complete discretion to change the system's parameters at a whim, which alters the actuarial situation essentially without oversight. The Thai case points to the necessity of establishing a board of trustees which is simultaneously independent and competent. Beyond these, other system design challenges include adequacy of benefits and coverage, affordability (at all levels), sustainability, robustness, and ensuring reasonable levels of income replacement coupled with a safety net for the elderly poor. While there is considerable variety in social security systems across Asian countries, there is

general agreeement that a multi-tier framework, one that strengthens the so-called "zero pillar" of social assistance or flat universal pensions, is most desirable.

In addition, even the core functions associated with any provident or pension fund are often taken for granted and poorly performed. These functions include everything from reliable collection of contributions and timely payment of benefits, to securing financial management and productive asset investment, all of which depend on effective communication, record keeping and financial reporting to ensure fiduciary responsibility, transparency and accountability. Part and parcel of designing and managing pension and provident fund systems is determining the most appropriate ways to invest these resources. Debates boil down to whether the objectives should be rooted in broad visions of strategic national interest, or whether the board of trustees responsible for investment should aim at maximizing returns for members given an established risk tolerance level. Rather than focus on the types of investments (for example, whether or not they are invested in infrastructure), the emphasis should be placed on the quality of the decisions and regulatory environment governing these decisions.

Following these remarks, Olli Kangas spoke about the role that pensions and pension funds played in state formation and constructing a national economy in Finland. Before the passage of its first pension scheme in 1937, Finland was among the poorest countries in the world. A historically strong and independent state took a nation-building approach to the Finnish welfare state, developing a fully funded, defined-contribution pension scheme whose primary purpose was the accumulation of capital to spur economic growth. The system underwent significant reform several times, the first of which, in 1956, converted the fully funded system to pay-as-you-go. Because of wide perceptions that the public entity in charge of the funds had confiscated previous funds and distributed them to the rural population, the new plan forfeited the support of trade unions that had been so instrumental in securing the passage of the original scheme. Five years passed before an agreement between conservatives, trade unions and the employers' federation could be reached that would create a totally legislated defined-benefit scheme which was partially funded, and partially pay-as-you-go. Not only did private insurance companies act as insurance carriers, but private funds were then administered by social partners, solidifying political support. Finally, in 1966, two public sector schemes—one for municipal and one for state employees—were created to complement the already existing private schemes.

Notwithstanding the importance of building political support for national pension reforms, the design and investment strategy tied to the funds was a key determinant in Finland's achievement of its desired developmental outcomes. A central part of the investment strategy prior to the 1980s was "safe" investment in the domestic industrial sector. Indeed, up to one-third of all loans went back into industry, while an important amount also went to the construction sector, providing jobs and housing in a context of urbanization. Indeed, pension funds were explicitly invested in national industries in order to promote national development. Liberalization of credit markets toward the end of the 1980s ushered in an era of high-risk, high-return investments for the pension insurance market. Because foreign investments offered higher dividends, the share of investments in the domestic market fell steadily over subsequent decades, dropping most drastically from 60 per cent in 2000 to 30 per cent in 2006. Whereas previous funds were collected and put to use within the national economy, new contributions, although still collected nationally, are invested abroad. These shifts in investment portfolios have positive effects on pensions and pensioners (for example, better interest rates, greater risk sharing and lower contributions), but these social welfare effects for beneficiaries must be weighed against the broader developmental implications of investing abroad, such as the potential diversion of resources away from national industrial projects.

Taken together, the Finnish and Asian cases raise central questions about the relationship between the social functions of pension funds and the goals of national economic development. Roddy McKinnon commented on the presentations, affirming the productive and protective roles of social security funds, whereby social security programmes are conceived as a precondition—rather than merely an outcome—of development. Indeed, the presentations lend credence to the idea that governments may realize developmental synergies by taking advantage of the relatively "cheap money" made available through pension and provident funds to achieve longer-term developmental objectives. However, the presentations also show that a continuing "win-win" situation is

far from guaranteed given the increasing demands for improvements in technical and administrative capacity and, perhaps most importantly, transparent and accountable institutions that can readily adapt to changing social, economic and demographic realities.

Whether or not the investment of funds is publicly or privately managed can also be important, but depends largely on the national context. Nonetheless, in the cases of provident funds in Asia and private funds in Latin America, funds have been invested in government debt and hence contributed to infrastructural development, often directing investment into prioritized economic sectors (this has also been seen in Europe, for example, in electricity generation in Finland).[6] The large-scale investment of pension funds in development projects inevitably begs an important question: is the risk to benefits arising from politically motivated investments and potentially below-market rates of return justified by the expected returns associated with national development? Conventional wisdom holds that national development is impossible without large-scale domestic capital accumulation, and insofar as pension funds are often the most (in some cases, only) accessible and dependable pools of domestic financial resources, the developmental potential they represent has sometimes trumped concerns related to benefit adequacy.

Finally, the presentations concluded that social security has an important role to play in managing the risks that come with globalization, but as recent transparency initiatives expand to the area of pensions, demands to liberalize fund investment strategies, not least with the aim of improving future benefits, have increased. These complex dynamics—the "democratization" of pensions—could have lasting implications for national investment and development strategies.

Concluding Remarks

In her concluding remarks to the workshop, Hujo suggested that one useful way to approach the financing of social policy was through the lens of the multiple roles of social policy, and that this conceptual framework could be especially useful for empirical research at the country level. Exploring how social policy influences the productive and reproductive economies, and how it impacts on redistribution and protection, draws attention to linkages and possible synergies between social and economic policy, which can only be exploited if both areas are integrated into a comprehensive policy framework from an early stage. This demands going beyond the short-term emergency approaches of mainstream debates and developing a long-term development strategy with a clear vision of both the role of social policy and the kind of political and social coalitions that are needed to promote this strategy.

The presentations and discussions at the workshop pointed toward several challenges—macroeconomic, political and global—for financing social policy. The macroeconomic challenge is twofold: first, to move toward a new economic model, which promotes income creation and employment; and second, to manage and allocate resources in a way that is conducive to social development. This second challenge is especially demanding with regard to foreign exchange inflows, due to their complex effects on macro variables and the rather limited effectiveness of policy tools in developing countries.

Regarding politics, the key challenge is to foster a national consensus on social policy and corresponding financing mechanisms based on universalism and equity. Yet without adequate state capacity and reliable mechanisms to hold decision makers accountable, it is difficult to raise revenues, guarantee a fair and transparent budget process, and deliver benefits and high-quality social services. In general it was acknowledged that expanding coverage and socioeconomic rights is part of a democratic and inclusive development process. Nevertheless, this poses significant challenges in developing countries due to their internal economic and political structures, and their peripheral position relative to world markets and politics.

Finally, financing social policy has an important global dimension, as illustrated by multiple projects and programmes of donors and international organizations. In this area, Hujo said, the research project would aim to do the following: focus on aspects of global and regional governance; analyse the potential of innovative financing mechanisms; bring new perspectives to old instruments like aid; and explore the impact of the global economy on policy space in developing countries.

[6] However, it should also be noted that in the case of mature pension schemes in Latin America, the investment of funds in bonds was not developmental, but instead financed transition costs brought about by the drop in contribution revenues to the state.

Agenda

Thursday, 1 March 2007

Opening Session

9:00–9:30
Welcome and Introduction to UNRISD, Thandika Mkandawire

9:30–10:00
Financing Social Policy: What are the Issues?, Katja Hujo

10:00–10:30 Discussion

Session 1
Financing Social Policy: Challenges and Constraints

Chair: Peter Utting

11:00–11:50 Presentation of Background Papers

Social Exclusion and Labour Markets in Latin America: Limits and Potential of Different Approaches, Rubén Lo Vuolo

Pro-Poor Financing of Social Services, Enrique Delamonica and Santosh Mehrotra

11:50–12:05 Discussant: Katja Hujo

12.05 – 12.45 Plenary Discussion

Session 2
Financing Social Policy: Taxation and Aid

Chair: Ylva Sörman Nath

14:00–14:40 Presentation of Papers on Taxation, Aid and Social Policy

Financing Developmental Social Policies in Low-Income Countries: Conditions and Constraints, Alice Sindzingre

Aid and the Financing of Public Social Sector Spending, Oliver Morrissey

14:40–14:50 Discussant: Thandika Mkandawire

14:50–15:20 Plenary Discussion

Session 3
Financing Social Policy: Remittances

Chair: Christiane Kuptsch

16:00–16:20 Presentation of Papers on Remittances

Remittances and Social Development: The Latin American Experience, Manuel Orozco (presented by Christiane Kuptsch)

Remittances and Social Development, Hein De Haas

16:20–16:30 Discussant: Parvati Raghuram

16:30–17:00 Plenary Discussion

Friday, 2 March 2007

Session 4
Financing Social Policy: Mineral Rents

Chair: Shahra Razavi

9:00–9:40 Presentation of Papers on Mineral Rents

Natural Resource Wealth and Development: Evidence and Issues, Andrew Rosser

Mineral Rents and Social Policy: The Case of the Government Oil Fund in Norway, Erling Holmøy

9:40–9:50 Discussant: Massoud Karshenas

9:50–10:20 Plenary Discussion

Session 5
Public Pensions, Social Insurance and Social Development

Chair: Warren McGillivray

10:50–11:50 Presentation of Papers on Public Pensions and Social Insurance

The Private Affairs of Public Pensions in South Africa: Debt, Development and Corporatization, Fred Hendricks

Public Pensions in a Development Context: The Case of Canada, Ed Tamagno

Social Insurance, Labour Markets and Coverage in Latin America, Carmelo Mesa-Lago

11:50–12:05 Discussant: Huck-ju Kwon

12:05–12:35 Plenary Discussion

Session 6
Pension Funds and Development

Chair: Carmelo Mesa-Lago

14:00–14:40 Presentation of Papers on Pension Funds

Provident and Pension Funds and Economic Development in Selected Asian Countries, Mukul Asher

Pensions and Pension Funds in the Making of a Nation-State and a National Economy: The Case of Finland, Olli Kangas

14:40–14:50 Discussant: Roddy McKinnon

14:50–15:20 Plenary Discussion

Closing Session

16:00–17:00
Wrap-Up and Outlook, Katja Hujo

Participants

Mr. Pascal Annycke
Independent Consultant

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Ms. Christina Behrendt
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