Universalism Promotes Development: Evidence from Southern Africa’s Social Transfers

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Abstract
This paper reviews evidence for developing countries on how the poverty-reducing and equality-promoting effects of social transfers support economic growth and development, particularly in the context of universalism. The first section after the introduction discusses theoretical considerations and the following section reviews existing evidence primarily from African countries. The subsequent section presents new evidence from South Africa’s most recent Labour Force Survey, which demonstrates the increasingly universal direction of the country’s social grants. The final section discusses macroeconomic and fiscal implications, documenting the long term sustainability of the developmental impacts.

Introduction
Effective social transfers reduce poverty and inequality, and these social effects generate important growth and development impacts in many developing countries. This paper outlines a theoretical framework through which social transfers generate these effects, and discusses experiences in developing countries with a focus on the impact of South Africa’s social grants.

Policymakers are increasingly recognising the importance of social transfers (including social pensions, grants for children and families, public works schemes and other programmes) in achieving the Millennium Development Goals. Social transfers not only tackle income poverty, they also provide effective support for broader developmental objectives. Households in developing countries spend social transfer income primarily on food, improving nutritional outcomes. In many countries, social grants are distributed largely to women, promoting empowerment and more balanced gender relations. Better household living standards facilitate education and improve health outcomes—particularly for women and children. Social transfers also provide a role in the protection strategy for those afflicted by HIV/AIDS, malaria and other debilitating diseases. Long a vital tool for industrialised countries, social transfers are increasingly recognised as an essential policy element for low- and middle-income nations.

In addition to their vital social contribution, social transfers can support critical economic objectives. Many of the world’s fastest growing economies over the past several decades have built social protection into their policies at early stages because of its potential to increase productivity and contribute to stabilising domestic demand. The failure to provide appropriate social protection limits prospects for growth and development at the very foundation of society because household poverty undermines children’s nutrition and educational attainment, limiting their future prospects. Poverty traps individuals and households—even entire countries—stifling human dignity and eroding potential. Poverty reproduces itself generation after generation, challenging policy-makers to take imaginative and bold steps to transform their nations. Social transfers are increasingly acknowledged as an effective tool to reduce this inter-generational poverty.

This paper defines social transfers as regular non-contributory payments of money provided by government or non-governmental organisations to individuals or households, with the

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objective of decreasing chronic or shock-induced poverty, addressing social risk and reducing economic vulnerability.\(^2\) The transfers can be unconditional, conditional on households actively fulfilling human development responsibilities (education, health, nutrition, etc.) or else conditional on recipients providing labour in compliance with a work requirement. The transfers can be universal or explicitly targeted to the poor and vulnerable.

This paper first discusses the linkages among poverty, inequality, social protection and growth and identifies theoretical relationships. Then the paper discusses the range of evidence for many developing countries—particularly in Africa. The next section focuses on labour market evidence in South Africa, and the final section draws linkages between growth and fiscal affordability.

**The theoretical context**

While the ongoing debate concerning the relationship between inequality and growth has failed to yield a resolution, few dispute that severe inequality undermines growth prospects. High inequality certainly reduces the impact of growth on poverty reduction. In a globalised world, growth increasingly depends on high quality human capital—inequality skews the distribution of education and other forms of human capital, and reflects a situation in which the poor cannot participate fully in the economy. And inequality erodes social stability—detering investment and undermining growth prospects.

Social transfers directly tackle inequality and poverty—they transfer resources from upper income to the lowest income households in a relatively efficient manner. In many ways they promote economic growth. They provide households with resources to invest—in nutrition, education, health and other forms of human capital. They also provide security that underwrites the higher risk of more productive ventures. Social transfers also provide immediate liquidity that some recipients employ to finance immediate investments.

Yet some economists continue to posit a conventional view that there is a negative trade-off between social protection and growth. This is illustrated in the diagram to the left by the downward sloping curve. For example, the United Kingdom is depicted with a relatively high economic growth rate compared to Denmark, which in turn reflects a relatively high level of social protection. For the United Kingdom to increase its level of social protection, the negative trade-off implies it would have to sacrifice some economic growth, as reflected by the directions of the arrows.

The wealthiest countries in the world—as a group—have the most comprehensive systems of social protection. Social security is an essential basic service in all successful states that have experienced long-term sustainable growth rates along side successful poverty

\(^2\) This adapts DFID’s (2005, page 6) and Devereux’s (2005, page 3) definitions of social transfers and incorporates McCord’s (2005, page 5) definition of public works programmes.
reduction. This empirical regularity contradicts the notion of a negative trade-off, although some economists continue to speculate about its existence.

A more important question interrogates behaviour at low levels of social protection. The lower the level of social protection, the more likely additional investments in social security promote economic growth. South Africa provides one convincing example. Prior to democratic elections in 1994, social protection was abysmal, and economic growth languished. By 2000 the government had implemented an improved social security framework and economic growth turned positive. Over the past five years spending on social protection has tripled—and the economy has enjoyed its broadest economic expansion in decades. A positive relationship between social protection and growth—as illustrated in the diagram to the right—suggests that South Africa's experience is not coincidental.

Understanding the relationship between social protection and growth requires a comprehension of the multiple dimensions of poverty. The diagram below illustrates the multi-dimensional nature of poverty. Income and asset poverty undermines human capabilities and traps people in geographic locations deprived of developmental opportunities. The poor often lack the organisational power to make their voices heard, and institutions weakly serve the poorest.

Source: Deepa Narayan, Robert Chambers, Meera Shah and Patti Petesch. Voices of the Poor. Crying out for Change, page 249
Each dimension of poverty can reinforce the other dimensions—and addressing one dimension can potentially influence the others. Social transfers directly tackle income poverty—but the inter-linkages lead to broader impacts in terms of health, education, security, empowerment and other broadly developmental objectives.

Mapping the dimensions of poverty describes the empirical basis for this theoretical framework. The Poverty Map to the left shows the concentration of households living on less than two dollars per day—the deepest shades reflect regions where more than half the households are poor. The map shows that poverty is geographically concentrated in rural areas deprived of infrastructure, particularly in those regions removed from major roads.

A map of unemployment shows the same patterns of concentration. In the Unemployment Map to the right, the deepest shades reflect concentrations of households with no employed members in excess of 70%. The patterns of poverty coincide with the patterns of unemployment—documenting the inter-relationships between these two conditions. In South Africa, poverty and unemployment go hand in hand, highlighting the concern between social protection and labour markets.

The dimensions of poverty extend much further. For South Africa maps of hundreds of social indicators—such as reliance on paraffin as opposed to electricity for lighting—with the numerous resulting poisonings and burns—provide a clearer picture of how poverty affects people. In the Lighting Map below, the deepest shaded areas reflect regions where over 79% of the households rely on paraffin or candles for lighting. School attendance rates, health indicators, access to safe water, telephones—all of the indicators paint the same pattern across the province and the nation.

Social protection tackles income poverty—and through the intricate linkages, it affects the other dimensions of poverty and inequality. Many of these interactions bolster economic growth.
The diagram below illustrates the main transmission mechanisms through which social transfers affect growth—through improved risk management, productive asset protection, human capital development in terms of nutrition, health, education, improved equity from offsetting discrimination, employment and various macro-economic effects. The improvements in social services directly improve human well-being—hunger is reduced, health improves, people benefit from education, people feel more secure, they have jobs, there are macroeconomic benefits.

These factors also promote economic growth, and there’s a multiplier effect contributing to improving people’s well-being from that economic growth. The economic growth also expands the tax base, and supports fiscal sustainability. This can further support the expansion of social transfers, and trigger a virtuous circle.

Social protection, livelihoods and employment: a review of some evidence
Social protection provides an opportunity for policy-makers to positively support livelihoods and employment. Experience in Africa and the rest of the world document the developmental impact of social security.

Shocks in Ethiopia are central to the life of the poor—and threaten productive assets and create poverty traps. In a recent study nearly every poor household in the sample experienced a severe shock that intensified their poverty. Over a five year period (1999-2004), 95% of families listed at least one serious shock that led to hardship, including drought (47%), a death in the household (43%) or a serious illness (28%). The poor are more risk averse when they have no insurance or safety net to protect them.

It is not just the shock that is the problem—the poor respond to this unmitigated risk by making decisions that are safer—but yield lower returns. They choose crops that are more likely to succeed—even if the expected returns are lower than with higher yielding but riskier varieties. They cannot afford to take on that risk.

A similar effect is observed in Tanzania, where unmitigated risk leads to investment behaviour that lowers the expected returns by about 25%, reinforcing poverty traps. In the absence of risk mitigation instruments, the poor invest in assets with safer but lower expected returns. With insurance-like mechanisms, however, the poor take greater risks with much higher expected returns—and can break the poverty trap.

One reason the productive impact of risk mitigation is so great is that the adverse consequences of unmitigated risk are so severe—and so persistent. Zimbabwe provides further evidence, where shocks exert negative impacts for decades. A study quantifies a

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3 See DFID (2006) for a further discussion.
5 And India. Stefan Dercon (2006).
40% reduction in the capital stock of the poor due to unmitigated risk. Drought and war in Zimbabwe exert a significant negative impact on children sixteen years later—leading to a 7% loss of lifetime earnings. Ethiopia and Kenya demonstrate similar long term impacts.

Drought in Kenya affects the spectrum of the poor in multiple ways. The very poorest face starvation—utter destitution. Those who are poor but have some assets often must sell these productive assets in order to survive, and this intensifies their poverty. Those who are less poor nevertheless face economic decline all around them. As a result they face fewer economic opportunities and a greater likelihood of falling into poverty.

Social protection serves as an effective insurance mechanism protect the poor—enabling them to take on prudent risks that promote their livelihoods. When the poor have access to insurance-like social protection mechanisms, they take greater risks that yield higher returns—and in some cases break out of poverty. Social transfers support livelihoods across the whole spectrum of poverty—by protecting the consumption of the most destitute, preserving the assets of the poor (which otherwise would be sold for survival) and broadly increasing economic activity.

Many African countries—particularly in Southern Africa—demonstrate strong evidence of the positive pro-poor growth impact of social transfers. In 1950 Mauritius introduced what became a non-contributory universal pension, which today costs approximately 2% of national income. The social pension represents a social contract that has laid a foundation for stability, growth and development. Today, Mauritius has the lowest poverty rate and highest per capita income of any SADC country. Similarly in Botswana, the social pension implemented in 1996 has significantly reduced inequality in one of Africa’s (and the world’s) most unequal countries. Costing less than half a percent of national income, the pension has provided one of the country’s main instruments for sharing growth, supporting the social stability required for ongoing investment.

In Zambia’s Kalomo cash pilot—initiated a few years ago and targeting the poorest households in the country—participants immediately invest a significant proportion of the cash transfers. This multiplies the value of the transfer to the recipients—while providing employment for others in the community and boosting economic growth. Similar investment effects are observed in South Africa, Brazil and Mexico. Households face serious credit constraints, yet seek to invest when provided the opportunity. Social transfers provide enough insurance protecting against the downside of risk—the guaranteed income provides assurance that they can invest without facing the most dire consequences if the investment fails to pay off. In DFID’s pilot in Kenya, for example, one woman used her transfer to buy inputs to make soap, which she sold over the course of the month, multiplying the value of the cash payment.

The world’s newest universal social pension—implemented in Lesotho in 2004—promotes human capital accumulation, particularly for orphans and vulnerable children. While formal evaluations are still in progress, preliminary evidence suggests it plays an important role supporting older people taking care of grandchildren whose parents have died from AIDS. Social transfers in Namibia support labour market participation and local economic activity. Close to universal take-up of the social pension provides a broad impact. Social transfers often provide enough support to households that woman can migrate to look for work. In particular, access to social pensions is associated with out-migration from rural areas, suggesting that young adults migrate to cities to look for jobs.6 Cycles of economic activity coincide with the cash injected into the local economy on pension day.

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6 Barrientos and Lloyd-Sherlock (2002)
Non-contributory pension programmes in Latin American countries generate similar development effects. Extreme poverty is 16% lower in households with pension income than in those without pension income in Argentina. Headcount poverty among households with pensioners is significantly lower than those without in Brazil. There is also a strong association between the presence of female pensioners and school enrolment of girls aged between 12 and 14. 

South Africa contributes a substantial body of evidence. The grants are among the most generous in the developing world, and take-up rates are relatively high by international standards. The extensive and high quality data that is available has supported studies by researchers around the world. The studies document the strong growth and development impact in terms of human capital, employment and the macroeconomic effects. Duflo (2000) finds that the household with an eligible woman for Older Person’s Pension increases the weight-for-height of girls significantly, while there was no effect on boys and in the household with an eligible man. Other studies in South Africa show that poverty and its associated consequences erode the opportunities for children and youth to attend school, fomenting a vicious cycle of destitution by undermining the household’s capacity to accumulate the human capital necessary to break the poverty trap. Many poor children cannot attend school due to the costs associated with education, including the necessity to work to supplement family income. In addition, communities that are resource-constrained provide lower quality educational services, which negatively affect enrolment rates. 

South Africa’s social grants counter these negative effects by providing households with more resources to finance education. Children in households that receive social grants are more likely to attend school, even when controlling for the effect of income. The positive effects of social security on education are greater for girls than for boys, helping to remedy gender disparities. Both the Older Person’s Pension and the Child Support Grant are statistically significantly associated with improvements in school attendance, and the magnitudes of these impacts are substantial. To the extent that social grants promote school attendance, they contribute to a virtuous cycle with long term dynamic benefits that are not easily measured by statistical analysis. 

Spending in households that receive social grants focuses more on basics like food, fuel, housing and household operations, and less is spent on tobacco and debt. All major social grants—the Older Person’s Pension, the Child Support Grant and the Disability Grant—are significantly and positively associated with a greater share of household expenditure on food. This increased spending on food is associated with better nutritional outcomes. Households that receive social grants have lower prevalence rates of hunger for young children as well as older children and adults, even compared to those households with comparable income levels.

**Social transfers and the labour market impact in South Africa**

Conventional economic theory suggests that social grants may undermine labour force participation by reducing the opportunity cost of not working. Models developed for industrialised countries and applied broadly to South African data sometimes corroborate this hypothesis. However, when models are developed that reflect the labour market behaviour of South Africans who receive social grants, the results contradict this hypothesis. The response of very low income South Africans to a marginal increase in their income is significantly different from the response of median income South Africans.

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7 Barrientos and Lloyd-Sherlock (2002)
The evaluation of the labour market impact requires the employment of an economic framework that interacts job search by workers (labour supply) with their ability to find a job, which depends on the willingness of firms to hire them (labour demand). A study by EPRI in 2004 found that workers in households receiving both pensions and child support grants looked for work significantly more extensively and intensively, and found employment more successfully. Disaggregated analysis into urban and rural areas and by gender documented that these effects are particularly strong for rural women.

In the absence of social protection, poverty demands a private safety net—primarily financed from the meagre resources of the working poor. This amounts to a very regressive tax that erodes worker productivity and stifles demand for labour. Social transfers constitute poverty tax relief—and can stimulate job creation.

EPRI’s 2004 study demonstrated that from September 2000 to February 2001, labour force participation rates rose in households receiving social transfers—yet fell in those that did not. The study also showed that unemployment rates fell over the same time period in households receiving social transfers—yet rose in those that did not. This suggests that South Africa’s social grants are associated with improved labour market activity. A simple comparison illustrates the results of the more rigorous econometric analysis. For the country as a whole, labour market participation rose by 0.6% from September 2000 to February 2001. However, for those households that did not receive social grants, labour force participation fell by 1.1%. Labour force participation rates in households receiving social grants rose by 3.3%—countering the negative effects in non-grant households and accounting for the national increase. The same effect is observed when one analyses the expanded definition of the labour force participation rate. More rigorous evidence stems from statistical models built on the survey data that control systematically for differences among households. Social grants are positively and significantly associated with improvements in labour force participation. There is no evidence that social grants foster dependency.

This greater participation was rewarded with greater success in finding employment—suggesting that social transfers are consistent with increased labour demand. While unemployment rates rose in households not receiving social grants, they fell in households that received the grants. Workers in households not receiving grants experienced an increase in unemployment rates from September 2000 to February 2001, while unemployment rates in households receiving grants fell. Again, a simple comparison illustrates the results of

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<tbody>
<tr>
<td>Official participation rate (Statistics South Africa)</td>
<td>58.7%</td>
<td>59.3%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Labour force participation rate for households not receiving social grants (EPRI, Oct. 2002)</td>
<td>61.4%</td>
<td>60.3%</td>
<td>-1.1%</td>
</tr>
<tr>
<td>Labour force participation rate for households receiving social grants (EPRI, Oct. 2002)</td>
<td>36.8%</td>
<td>40.1%</td>
<td>3.3%</td>
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<tr>
<td>Difference in change for households receiving social grants (EPRI, Oct. 2002)</td>
<td></td>
<td></td>
<td>4.4%</td>
</tr>
<tr>
<td>Official unemployment rate reported by Statistics South Africa</td>
<td>25.8%</td>
<td>26.4%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Unemployment rate for households not receiving social grants (EPRI, Oct. 2002)</td>
<td>23.2%</td>
<td>24.7%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Unemployment rate for households receiving social grants (EPRI, Oct. 2002)</td>
<td>39.1%</td>
<td>37.8%</td>
<td>-1.3%</td>
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<tr>
<td>Difference in change for households receiving social grants (EPRI, Oct. 2002)</td>
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<td>-2.8%</td>
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the more rigorous econometric analysis. For the country as a whole, the unemployment rate rose by 0.6% from September 2000 to February 2001. For those households that did not receive social grants, the unemployment rate rose by 1.5%. However, the unemployment rate in households receiving social grants fell by 1.3%—dampening the negative effects in non-grant households and reducing the national increase in unemployment. The same effect is observed when one analyses the expanded definition of the unemployment rate that does not exclude discouraged workers. Again, the statistical models that control systematically for differences among households provide more rigorous results. Social grants are significantly associated with reductions in the unemployment rate. Again, there is no evidence that social grants foster dependency. This result is consistent with the hypothesis that social transfers help to overcome poverty’s impact taxing the working poor.

More recent data confirms the result that working age adults in poor households that receive a social pension are more likely to look for work and more likely to find employment than comparable adults in households that do not receive the social pension. Matching the September 2004 Labour Force Survey to the March 2005 survey and correcting for mismatched individuals provides a dynamic picture of how labour force participation changes for households receiving and not receiving the social pension.9

The table below compares the change in labour market participation for working age adults (those older than 16 years) in households with no employed individuals in September 2004 but including at least one older person (defined in terms of age eligibility for South Africa’s older person’s pension). The first row of data shows the proportion of adults who were employed in March 2005, broken down by status in terms of household receipt of the social pension. The second row shows the proportion of adults who were actively looking for work but not employed. (None of the adults in this sample were employed in September 2004.) The third row shows the proportion of adults who were not participating in the labour force.

<table>
<thead>
<tr>
<th>Probability that a poor working age adult will:</th>
<th>Household receives social pension in 2004</th>
<th>Household does not receive social pension in 2004</th>
<th>Improvement associated with social pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Find employment in 2005</td>
<td>9%</td>
<td>7%</td>
<td>2%</td>
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<tr>
<td>Be actively looking for work in 2005</td>
<td>15%</td>
<td>13%</td>
<td>2%</td>
</tr>
<tr>
<td>Not participate in the labour force in 2005</td>
<td>76%</td>
<td>80%</td>
<td>4%</td>
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NOTE: Sample includes working age adults (older than 16) in households in the lowest income quintile with older people but with no working individuals in September 2004.


In households that received the social pension, 9% of adults were employed in March 2005 and another 15% were actively looking for work. In households that did not receive the pension, only 7% were employed and another 13% were actively looking for work. Receipt of the social pension was associated with a 2% higher probability of finding employment and a 2% higher probability of actively looking for work. Alternatively, receipt of the social pension was associated with a 4% lower probability of not participating in the labour force.

The child support grant demonstrates a similar effect. Working age adults—particularly women—in poor households that receive a child support grant are more likely to look for work and more likely to find employment than comparable adults in households that do not

9 The results from the uncorrected data are presented in the appendix. The results are not materially different. After September 2004 Statistics South Africa ceased to track social grant status in its Labour Force Survey.
receive the child support grant. The matched Labour Force Survey similarly provides a
dynamic picture of how labour force participation changes for households receiving and not
receiving the child support grant.

The tables below compare the changes in labour market participation for working age adults
and working age women in households with no employed individuals in September 2004. The rows follow the format of the table above, with the first row showing the proportion of adults who were employed in March 2005, broken down by status in terms of household receipt of the child support grant. The second row shows the proportion of adults who were actively looking for work but not employed, while the third row shows the proportion of adults who were not participating in the labour force.

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<th>Table: Impact of the child support grant on labour force participation (corrected data)</th>
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<td>corrected data</td>
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<tr>
<td>Probability that a poor working age adult will:</td>
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<tr>
<td>Find employment in 2005</td>
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<tr>
<td>Be actively looking for work in 2005</td>
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<tr>
<td>Not participate in the labour force in 2005</td>
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NOTE: Sample includes working age adults (older than 16) in households in the lowest income quintile but with no working individuals in September 2004.


In households that received the child support grant, 15% of adults were employed in March 2005 and another 20% were actively looking for work. In households that did not receive the child support grant, only 13% were employed and another 17% were actively looking for work. Receipt of the social pension was associated with a 2% higher probability of finding employment and a 3% higher probability of actively looking for work. Alternatively, receipt of the child support grant was associated with a 5% lower probability of not participating in the labour force.

The effects are even stronger for women, as documented in the table below. In households that received the child support grant, 15% of adults were employed in March 2005 and another 20% were actively looking for work—the same proportions as for all adults. In households that did not receive the child support grant, only 12% were employed and another 14% were actively looking for work. Receipt of the social pension was associated with a 3% higher probability of finding employment and a 6% higher probability of actively looking for work. Alternatively, receipt of the child support grant was associated with a 9% lower probability of not participating in the labour force.

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<tr>
<th>Table: Impact of the child support grant on female labour force participation (corrected data)</th>
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<tr>
<td>corrected data</td>
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<tr>
<td>Probability that a poor working age woman will:</td>
</tr>
<tr>
<td>Find employment in 2005</td>
</tr>
<tr>
<td>Be actively looking for work in 2005</td>
</tr>
<tr>
<td>Not participate in the labour force in 2005</td>
</tr>
</tbody>
</table>

NOTE: Sample includes working age women (older than 16) in households in the lowest income quintile but with no working individuals in September 2004.

While the magnitudes of these effects are relatively small, it is important to emphasise that social transfers are not intended as employment generating schemes. Their major impact is social protection—with support of labour market participation an ancillary outcome. Nevertheless, this evidence contradicts the misplaced notion that social grants create dependency. On the contrary, social grants support households to participate more actively and successfully in the labour market, assisting workers to break the poverty trap.

**The macroeconomic and fiscal effects**
Social transfers affect the macro-economy through two distinct sets of transmission mechanisms. First, they affect the composition of spending—by transferring spending power from upper income groups to the poor. Depending on the labour-intensity and import content of the spending of different income incomes, the redistributive effect of social transfers may reduce imports and increase the demand for labour, supporting job creation. Within a national economy, the support of spending power in remote rural areas holds the potential to revitalise local economies.

Analysis of EPRI’s sectoral macro-simulation model demonstrates the positive macroeconomic impact of social transfers. Capacity utilisation is low by historical standards, and a significant proportion of excess capacity is attributable to insufficient demand. This suggests that the increase in demand from redistributive transfers is unlikely to have a significant inflationary impact. In addition, the demand of low income groups is concentrated on sectors in which South Africa produces most of the demanded goods domestically, and in a relatively labour intensive manner. This suggests that the composition effects of social transfers are likely to improve the trade balance and increase the demand for labour.

For example, the poor spend relatively more of their income on food compared to upper income households. South Africa produces domestically most of its food consumption requirements, and the technology is relatively labour intensive compared to manufactured goods.

Figure: Spending on food by income group in South Africa

![Graph showing spending on food by income group in South Africa](source: Statistics South Africa I&E2000 Survey and EPRI Micro-simulation model)
Upper income households, on the other hand, spend more on transportation—often automobiles that are imported or include a very high import content. Automobile production in South Africa is relatively capital intensive compared to food production.

Figure: Spending on transportation by income group in South Africa

Social transfers shift spending power from upper to lower income households—the composition of spending tends to shift, for example, from automobiles to food grains. On average across all sectors, the composition of spending tends to shift from imports to domestic goods, from capital intensive to labour intensive. In general, these effects in any specific country will depend on how different income groups spend.

The second major type of macroeconomic effect stems from investment, which depends on the change in the risk-adjusted return on capital as affected by reduced inequality, better education and improved social stability. The increase in take-up of social grants in South Africa over the past five years has significantly reduced South Africa’s Gini coefficient as the income differentials across the income distribution have fallen. The increasingly progressive tax structure that has financed social grants has reinforced the reduction in the Gini coefficient. Using the data provided in the 2000 Income and Expenditure Survey, this study developed a simulation which determined how the Gini coefficient would change under a scenario of full take-up State Old Age Pensions, Disability Grants, and Child Support Grant. The simulation quantifies a reduction in the Gini coefficient of 3 percentage points, from 63% to 60%. The figure below depicts the Lorenz curve for total household income both before and after the simulations. The straight 45-degree line is the distribution of income in a perfectly equal society. The curve on the right represents the income distribution before full take-up and the curve on the left represents the distribution after the increased take-up. The shifting up of the Lorenz curve represents the significant improvement in income distribution resulting from South Africa’s social security system.
Social transfers must be financed—either from the government’s budget and/or with donor support. In some cases the programmes can cost up to 3% on national income. The affordability of social transfers depends in part on their economic impact. Growth expands the country’s resources—and usually the revenue available to the government.

Social transfers also conserve fiscal resources in important ways. The infant whose nutrition was funded by a social transfer will grow into a school-age child better able to learn—and more likely to succeed in school. Fewer fiscal resources will be wasted on children who have to repeat grades they otherwise would have passed. The child will grow into an adult more likely to find work—and pay taxes. The worker will grow older with a lower chance of contracting a chronic debilitating disease, like diabetes which is a severe problem in South Africa—and so be less likely to unnecessarily burden the public health care system.

Social transfers can support a virtuous circle of growth, greater affordability and sustainability. Social grants represent a transfer of resources to the poor with the direct impact of reducing poverty. Social grants also create a long-term developmental impact by improving nutrition, health, education, labour productivity and social stability. The long-term impact of social grants is cumulative—an investment this year in social grants generates benefits over a multi-year horizon. As a result, social grant transfers build a “social grant capital stock” that generates real returns—in terms of economic growth, greater tax capacity and fiscal savings—over the long term.

The impact of the social grant capital stock can be modelled with a macro-simulation model. In this model, poverty reduction depends on economic growth and the social grant capital stock.\(^\text{10}\) Economic growth depends negatively on both the amount of taxes necessary to finance social grant spending as well as on the poverty gap.\(^\text{11}\) To close the model, it is necessary to specify a policy rule for social grant spending. It is assumed in the following scenario that social grant spending grows in line with the forecasts of the Medium Term Budget Policy Statement and then is linked to the poverty gap, falling as the poverty gap is reduced. The graph below depicts the results of the modelled scenario.

**FIGURE: A MODEL OF SOCIAL SECURITY’S ECONOMIC AND POVERTY IMPACT IN SOUTH AFRICA**

![Graph](source)

**SOURCE: NATIONAL TREASURY AND EPRI MACRO-SIMULATION MODEL**

\(^{10}\) 5% growth reduces the poverty gap by 0.05% of GDP. A stock of social grant capital equal to 5% of GDP reduces the poverty gap by 0.05%. Social grant capital depreciates 10% per year.

\(^{11}\) Taxation equal to one percent of GDP reduces the economy’s real growth rate by one-quarter of one percent. A poverty gap equal to one percent of GDP reduces the economic growth rate by one-quarter of one percent.
Over the medium-to-long term in this scenario, social grant spending peaks in 2007 and then falls to less than 2% of GDP by 2020, while economic growth rises to 5.8% by 2020, and the poverty gap falls to 2.8% of GDP in 2020. This scenario depicts how South Africa’s current projections for social grant spending can be sustainable.

Conclusions
Poverty has many layers, and social transfers tackle them in a comprehensive manner. They support broad household development, and improve labour market participation. For most developing countries, more effective social protection is likely to promote economic growth and development. Social transfers significantly reduce inequality—supporting social stability and fostering investment and economic growth. Well-designed social transfers do not create dependency—they often break dependency traps, particularly by nurturing productive high-return risk-taking. At a macro level they can help restructure the economy to support job creation and economic growth. Social transfers also create fiscal effects that support long-term affordability and economic sustainability.
APPENDIX: Labour market results from uncorrected Labour Force Survey data.

The matching methodology utilised for the analysis in this paper corrects a commonly cited problem with South Africa’s Labour Force Survey. The results reported, however, are not sensitive to the specific approach taken to match the records. Even with the correction, the results discussed are apparent in the uncorrected data. The tables below report the results employing the data prior to the matching correction. While there are small differences between these figures and those resulting from the corrected data, the magnitudes of the associated improvements are virtually the same.

### Table: Impact of the social pension on labour force participation (uncorrected data)

<table>
<thead>
<tr>
<th></th>
<th>Household receives social pension in 2004</th>
<th>Household does not receive social pension in 2004</th>
<th>Improvement associated with social pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probability that a poor working age adult will:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Find employment in 2005</td>
<td>9%</td>
<td>6%</td>
<td>3%</td>
</tr>
<tr>
<td>Be actively looking for work in 2005</td>
<td>15%</td>
<td>13%</td>
<td>2%</td>
</tr>
<tr>
<td>Not participate in the labour force in 2005</td>
<td>76%</td>
<td>81%</td>
<td>5%</td>
</tr>
</tbody>
</table>

NOTE: Sample includes working age adults (older than 16) in households in the lowest income quintile with older people but with no working individuals in September 2004.


### Table: Impact of the child support grant on labour force participation (uncorrected data)

<table>
<thead>
<tr>
<th></th>
<th>Household receives child support grant</th>
<th>Household does not receive child support grant</th>
<th>Improvement associated with child support grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probability that a poor working age adult will:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Find employment in 2005</td>
<td>15%</td>
<td>14%</td>
<td>1%</td>
</tr>
<tr>
<td>Be actively looking for work in 2005</td>
<td>20%</td>
<td>17%</td>
<td>3%</td>
</tr>
<tr>
<td>Not participate in the labour force in 2005</td>
<td>65%</td>
<td>69%</td>
<td>4%</td>
</tr>
</tbody>
</table>

NOTE: Sample includes working age adults (older than 16) in households in the lowest income quintile but with no working individuals in September 2004.


### Table: Impact of the child support grant on female labour force participation (uncorrected data)

<table>
<thead>
<tr>
<th></th>
<th>Household receives child support grant</th>
<th>Household does not receive child support grant</th>
<th>Improvement associated with child support grant</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probability that a poor working age woman will:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Find employment in 2005</td>
<td>15%</td>
<td>12%</td>
<td>3%</td>
</tr>
<tr>
<td>Be actively looking for work in 2005</td>
<td>20%</td>
<td>14%</td>
<td>6%</td>
</tr>
<tr>
<td>Not participate in the labour force in 2005</td>
<td>65%</td>
<td>73%</td>
<td>8%</td>
</tr>
</tbody>
</table>

NOTE: Sample includes working age women (older than 16) in households in the lowest income quintile but with no working individuals in September 2004.