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Stephanie Levy

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Department of International Development

London School of Economics and Political Science

Houghton Street

London

WC2A 2AE UK

Tel: +44 (020) 7955 7425/6252

Fax: +44 (020) 7955-6844

Email: s.levy@lse.ac.uk

Website: www.lse.ac.uk/InternationalDevelopment

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Abstract

Trade-offs between policies that promote economic growth and redistribute wealth are discussed extensively in the literature, both from a public finance perspective and from a macroeconomic angle. In fact, social safety nets are sometimes perceived by government in developing countries as a non-productive use of scarce public finance. Cambodia is an example of low middle income country that has so far been reluctant to implement a social protection floor for its vulnerable population and those unable to meet their subsistence needs. The Covid-19 pandemic has however changed not only the set of policies that the government has put in place to protect its population living in poverty, dedicating an unprecedented share of its budget to their funding, but it has also modified the role that policy makers aim for these interventions to play. These programmes are now increasingly perceived as a requirement to protect the growth of a country that was for decades the fastest growing economy in the world. This paper analyses the policy changes induced by the pandemic and presents empirical evidence that their economic effects are likely to be large. It then discusses the shift in political paradigm that this could lead to.

Keywords

Social Protection, Economic Growth, Cambodia, Covid-19, Economic Inclusion

Introduction

In many countries, Covid-19 has prompted the implementation of policies previously not thought possible (Gentilini et al. 2020). Cambodia is an example. Its economy has been growing very rapidly for two decades but the government was unwilling to implement a social protection floor for its population living in poverty. The political reluctance to implement such policies was mainly based on the perception that they were too costly, not always justified and diverting scarce public funds from growth promoting investment. Then the Covid-19 pandemic started. Although it so far had little health impact, it has caused a substantial external demand shock which hit key economic sectors and caused income loss. In response the Cambodian government introduced a large expansion of its social protection schemes, which now includes a social protection floor and raises the size of cash transfers to an extent that would have previously been thought unachievable. Our research analyses the impact of cash transfer programmes that correspond precisely to the new schemes, in terms of their population coverage, targeting strategies, benefit adequacy and modalities (Levy and Pipitone 2020 and Levy 2017). We find that implementing a universal social protection floor that follows the current

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modalities could lift 1.5 million Cambodians out of poverty while protecting the livelihood of many more. Beyond their positive economic impact, these new policies are changing the political economics of social protection in Cambodia. The political perception of trade-offs between social protection and growth that used to guide policy design, has now been replaced with the recognition that social protection is needed for growth to take place.

A new socio-economic context

The Covid-19 pandemic started at a time of rapid economic growth and social progress in Cambodia. With 8% average annual growth rate since 1998, it has been one of the fastest growing economies in the world (World Bank 2019). The government budget recorded a $50 million budget surplus in 2019, thanks to efficient collection and healthy management of revenue. Poverty incidence had fallen dramatically and access to social services was rapidly progressing (Levy and Pipitone 2020). The National Social Protection Strategy Framework (NSPSF) adopted by the parliament in 2017 and the IDPoor identification system opened the way for a social protection programme that aims at providing safety nets for Cambodia vulnerable population groups.

In Cambodia, the Covid-19 health crisis was not as severe as feared at the beginning of the pandemic and the infection incidence remained among the lowest in the world, with less than 500 cases and no deaths recorded to date. There has been no sectoral lockdown, no physical distancing and no domestic supply shock. Nonetheless there has been an external demand shock with a significant impact on the economy. The export sectors that have driven growth, have been substantially hit, causing an unprecedented income loss.

Tourism, construction, and manufacturing exports which have been the main drivers of economic growth for decades, suffered the greatest economic impact from the pandemic. These sectors, which are dependent on external demand, account for over 70% of Cambodia's gross domestic product, 80% of its exports and generate the largest source of fiscal revenue. Since March 2020, the collapse of external demand and the slowdown in investment, impacting the construction sector, have caused employment to fall, income distribution to worsen and threatened Cambodia's steady progress on poverty reduction.

New threats to livelihoods. These three sectors employ nearly 2 million workers, over 20% of Cambodia's labour force, a large share of which are low skilled and on low wages. Income loss resulting from the contraction of these sectors therefore threatens the livelihood of a significant number of already vulnerable households. Spillovers and multiplier effects from this economic shock could dramatically affect the incidence of households unable to meet their subsistence needs. Initial reports on sector contraction and employment decline, even though difficult to precisely estimate at this stage, point to a significant deterioration of income and livelihood in Cambodia.

We conducted a research study on social protection in Cambodia, the findings of which are relevant to understand the impact of the pandemic on the economic and policy context. Our research proposes, analyses and compares policy options to expand the existing safety net programme in terms of both population coverage and benefit adequacy. We consider a range of social protection interventions, both strengthening the current system and developing new complementarity strategies. We estimate the cost and the impact of these measures (i) at the household level in terms of livelihood impact and poverty incidence, (ii) from a fiscal angle, discussing affordability and funding options, and (iii) from a general equilibrium perspective, using micro-simulations to capture their wider impact on markets and growth.

To do so, we use the most recent household socio-economic surveys to analyse the demographic and the socio-economic characteristics of the Cambodian population, living costs and consumption patterns to estimate the adequacy and modalities of efficient social transfers. Graph A1 in the appendix presents the consumption distribution that we estimated on the basis of this data. The concentration of households just above the poverty line means that a small income loss for households at the bottom half of the distribution would lead to a surge in poverty incidence.

A new set of policies

In April 2020, the government engaged in an ambitious recovery plan that aims at protecting both the private sector's and the household's economies (Government of Cambodia 2020). Its first component aims to restore growth and mitigate the impact on the private sector, through investment and infrastructure development as well as support for structural changes of key production sectors. The second component aims to protect the livelihood of the most vulnerable and most affected Cambodians through a substantial expansion of cash transfer programs based on the IDPoor identification system.

Based on proxy-means testing, the IDPoor identification system allocates a poverty status for households at two levels of eligibility to social programmes. Cambodia safety net programmes consist in categorical transfers for selected vulnerable groups among the IDPoor card holder's population: the elderly, people living with severe disabilities, expectant mothers and those with young children, and primary and secondary school students. The NSPS Framework therefore does not plan for the development of a national *social protection floor* nor ensure coverage of a sizeable share of the working age poor (Levy and Pipitone 2020, OECD 2017). The size of the transfers is also low relative the subsistence needs and living costs. This weak benefit adequacy combined with the low coverage of the population living in poverty compromises the efficiency of the programme (Beegle et al. 2018).

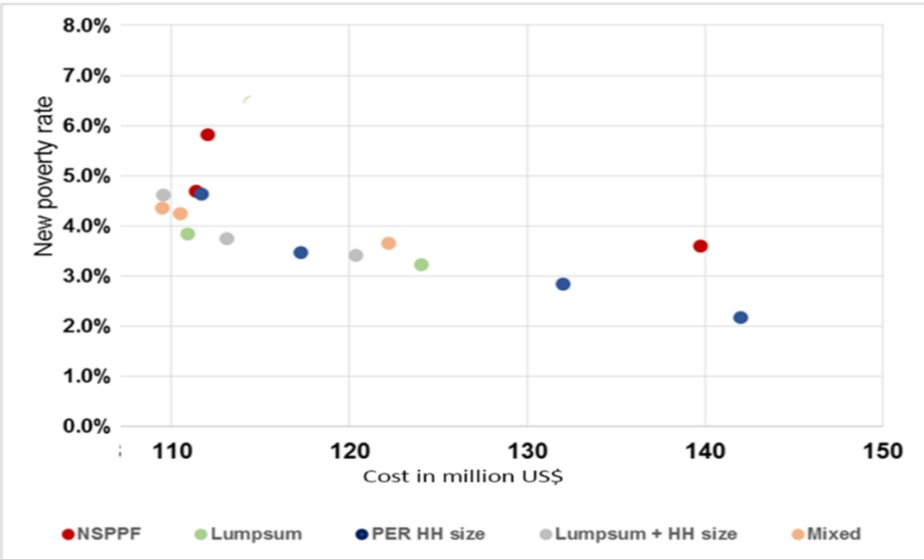
The modalities of the cash transfer programmes have temporarily changed under the new recovery scheme. They now provide a lump sum monthly transfer to all IDPoor households in addition to the same set of categorical transfers based on demographic characteristics of its members and scholarships. The new programme is therefore providing a social protection floor, as defined by ILO standards (ILO Recommendation No 202, 2012) and in line with international commitment to the Universal Social Protection objectives set by the United Nations Agenda 2030. The size of the transfers has also been substantially increased.

The social protection programmes we propose and analyse in our research paper include schemes with modalities identical to the ones currently implemented in response of Covid-19 crisis. We evaluate their potential impact and effectiveness at tackling poverty. Two of our findings are particularly relevant to the current policy context. First, we find that one of the most economically efficient uses of public funds consists of a social protection programme that accounts for household size, as well as schemes that complements lump sum transfers with categorical allowances. Graph 1 below illustrate the benefits of such programmes on poverty reduction compared to the NSPPF schemes at any level of public spending. The emergency cash transfer programme follows this precise strategy.

Second, we find that a transfer size of at least 20 per cent of the national poverty line is needed for the Framework's schemes to efficiently allow beneficiaries to meet their subsistence needs. While we found insufficient initial adequacy based on household subsistence needs and consumption reporting, the emergency cash transfer programme provides safety nets 3 to 4 times above this threshold for most beneficiary households, depending on their size and demographic characteristics. Our estimates show that it would cost about 80 million US dollars to reduce poverty by half in Cambodia using such a programme combining universal social safety nets and categorical allowances.

We find that if that budget was to be raised to 150 million US dollars, as currently planned in the new emergency fund, it would allow more than a million Cambodians to meet their daily subsistence needs. It is not possible at this stage to know the new poverty incidence resulting from the economic crisis, nor the impact the new schemes will have on it. We can however evaluate the potential impact of the new transfers, given their new modalities and scale, on the number that will be lifted out of poverty from our calculations. Therefore, even if temporary, this programme promises to achieve substantial poverty reduction, lifting well over a million Cambodian out of poverty and improving the livelihood of nearly 2 million Cambodian poor.

Graph 1- Public spending and poverty reduction by transfer policy



For as long as it lasts, the new emergency social protection scheme could, given its size and transfer modalities, lift a significant share of Cambodian's poor out of poverty. This represents an unprecedented political stance and policy progress towards the establishment of a universal social protection floor.

Fiscal space challenges. The sudden increase in population needing social protection represents a challenge both in terms of targeting strategy and identification of beneficiaries (Durán Valverde 2020). It also requires an increase in financial resources which can be particularly challenging to mobilise swiftly even in non-crisis circumstances. The Covid-19 crisis has been adding more complexity to such emergency policy process since government tax receipts are expected to decline by approximately 30% this year due to the contraction of sectors that have been major contributor to the fiscal revenues. The simultaneous increase in funding needs and contraction of government revenue constitute a substantial policy challenge.

The size of the emergency social protection budget is equivalent to 2% of the pre-Covid GDP, which represents a substantial deviation from its spending path and an extremely large fiscal effort, tripling the initial yearly budget for social assistance. While this level of expense is not sustainable from a fiscal perspective and cannot realistically be expected to remain as generous in the long term, it shows changes in the way social protection is used to respond to a new economic context, with new population needs and new threats to growth.

Preventing the propagation of economic shocks

Beyond their social assistance aim, the strategy that guided the design of the rescue policy package has a new objective: to allow for productive sectors to bounce back when external demand is restored. The nature of the economic shock means that the economy could restart when external demand bounces back – possibly fast for garments and possibly more slowly for tourism (Ly et al. 2020). Global objectives to diversify trade and value chain dependence on China create an opportunity for Cambodia to attract FDI and develop and diversify its industries and integrate new global value chains and trade.

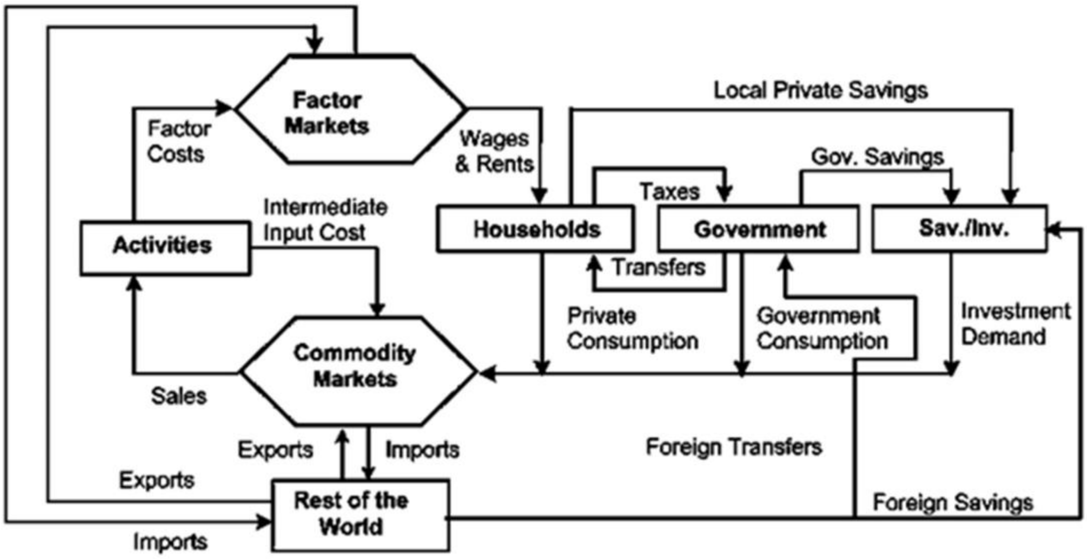
But for this to happen, the crisis damage to the economy needs to be limited. Household demand is a prerequisite to keep the economy from collapsing because if their demand for goods and services contracts as a results of income loss, the pandemic will affect other sectors and hurt the economy beyond the direct immediate impacts of the external demand shock. Such spillovers can compromise progress made for over two decades which included rural development, social progress and poverty reduction. **Even without lockdown or social distancing measures, and even with no direct impact on domestic supply, the impact of income loss on household demand could spread to so-far healthy production sectors and multiplier effects caused by demand shock aggravate the economic crisis.**

Analysing the general equilibrium impact of social protection. We develop a computable general equilibrium model (Lofgren et al. 2002, Devarajan and Robinson 2013) to capture and measure the potential economic effect of social transfers. Computable General Equilibrium (CGE) models are economic models that use empirical data together with a theoretical general equilibrium structure to understand how an economy may respond to changes in policy, technology or external factors.

A CGE modelling framework consists of a Social Accounting Matrix (SAM) and an algebraic model. A SAM is a dataset that represents financial flows and economic transfers between all agents during a given period of time, typically a year. It provides a snapshot of the whole economy of a country at a given point of time. The algebraic model consists in a set of equations representing the relationship between the different economic agents, calibrated on the basis of the flows captured in the social accounting matrix. The combination of the SAM and the algebraic model allows for the simulation of a large range of public interventions or policies, identifying and tracing their multiple impacts throughout the economy. General Equilibrium Models are widely used by policy makers and researchers to analyse the aggregate welfare and distributional impacts of policies whose effects would be transmitted through multiple markets and economic agents.

We develop a general equilibrium model to represent the economy of Cambodia, which is very similar to the International Food Policy Research Institute (IFPRI) standard CGE Model (2001) but adapted to analyse the micro-economic impact of social protection schemes through micro-simulations (Levy and Pipitone 2020). Graph 2 below represents the various components of our model and the relationship between economic agents which it aims at representing.

Graph 2: Economic blocks and financial flows within a CGE model (Lofgren et al. 2001)



We analyse the impact of the social protection programmes from two perspectives: (i) household consumption and income distribution, which includes poverty incidence and (ii) the local and wider economy, analysing effects of new demand on production, trade and economic growth.

The main results from our micro-simulations are as follows. Since Cambodian poor mainly consume domestic goods and services, we find that their transfer-funded consumption is likely to stimulate their local economies if scaled up to the current level, promoting wider economic growth. In the current context where depressed demand is hindering growth, this kind of direct support to households with this pattern of consumption is likely to protect sectors not directly hit by the economic impact of the pandemic, isolating them from the damage caused by the economic shock. The emergency social transfer scheme will therefore help the Cambodian economy to recover and bounce back towards its pre-crisis growth path.

Supporting demand to promote growth. The Covid-19 crisis has demonstrated the importance of ambitious and adequate policies and effective governance (Baldwin et al. 2020, Ilzetzki 2020, Gerard 2020, Gentilini 2020). Countries where support policy packages have been swiftly adopted and support measures adequately designed to respond to the needs in a tailored way have been the ones that best mitigated the impact of the pandemic on their populations. While this was particularly evident for the safeguarding of population health, it is now also well established for support to firms and private sector (Blanchard et al. 2020) as well as social protection for affected populations (Gerard et al. 2020, Hanna 2020, Vazirelli 2020), be it in the form of income protection and safety nets, cash transfers and food vouchers for school pupils.

Countries that put in place efficient and generous income support, like Germany and France, are more likely to engage in a rapid recovery path because such policies support and restore distorted demand more swiftly, stimulating and boosting economic growth (Baldwin et al. 2020). The ones with the least generous social protection, wage protection schemes and unemployment insurance, such as the United Kingdom, appear more prone to delay economic recovery. Even when lockdown ends and social distancing eases - allowing domestic production to recover- depressed demand is likely to continue hindering economic prospects. In the case of Cambodia where the Covid-19 crisis is mainly caused by an external demand shock, these emergency interventions have an especially strong potential to limit the propagation of the impact and promote economic growth.

The Cambodian government, mindful of such risks, has designed a response strategy that aims at mitigating them by supporting domestic demand. Unlike conventional safety nets, these new social protection measures do not face the risk of unpopularity given the current context. They are not tainted by disbeliefs in the role of social safety nets (Mkandawire 2005, Andrews et al. 2021). The Covid-19 crisis is indeed causing the emergence of a new population eligible for social safety nets who is on average more urban, younger and more integrated into the labour market than the pre-crisis IDPoor card holder population - it includes a pool of workers from sectors that are driving growth. They are therefore less likely to be perceived as disincentives for labour force participation given that they partially aim at mitigating the impact for those who have lost their jobs as the result of the shock (Andrews et al. 2021). Instead they are seen as an efficient tool, if not a necessity to protect economic growth.

Changing the political economy of social protection

The crisis has led to a political shift in the view of the role social protection can play beyond providing immediate assistance to those in need. The fact that it supports demand and could promote growth was not before considered as a determinant of policy design. Cambodia's social policy landscape had resulted from a political reluctance to develop a universal social protection floor, mainly perceived as too costly, diverting scarce public funding from investment considered more productive, with higher economic return. Our research analyses the fiscal space for social protection policies in Cambodia. We find that the pre-crisis budget surplus was sufficient to cover the costs of a social protection floor that would provide safety nets to all Cambodians not able to meet their subsistence, provided that they could be identified and targeted. Therefore the modalities of the social safety nets programmes resulted from a political choice to prioritise other types of public spending.

The political perception of trade-offs between social protection and growth that used to guide policy design is now been reshaped by the recognition that social protection is needed for growth to take place. And while social protection used to be seen as an alternative to growth promoting policies, the crisis has now made it a prerequisite for economic recovery. In that sense, the crisis has been a catalyst for change in the use and perception of the relationship between economic growth and social policies.

As in many other countries, the Covid-19 crisis has pushed the boundaries of the domain of policy possibilities in Cambodia. Our research shows that it would be beneficial for the livelihood of millions of Cambodians as well as for future economic growth prospects if these changes led to more permanent policy features - the changes in perception of their relationship to growth is the most encouraging and promising step in that direction. While the temporary scale of the transfers cannot realistically be maintained after the pandemic, the transition from categorical transfers to a social protection floor would foster Cambodia's transition to a high-middle income country.

Covid-19 revealed how fragile economies, even rich and technologically advanced, can be. Social protection reinforces resilience and prevents inequality from widening. Without redistributive policies, unequal, socially fragmented and less resilient social fabrics are likely to aggravate a crisis of unprecedented magnitude (Razavi et al. 2020). And the longer the Covid-19 crisis lasts, the more these mitigating policies will be needed to prevent social and economic effects from being durable.

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Appendix

Graph A1- Consumption distribution in Cambodia