

## ► Policy Brief

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# Investing in Social Protection for Economic Growth

## Multipliers of Social Protection – Nepal country case study

### Key points

- [1] The **economic returns from social protection investment in Nepal are substantial** as suggested by the estimated fiscal multipliers.
- [2] An **increase of 1 Nepalese rupee in social protection expenditures** leads to a Gross Domestic Product (GDP) **increase of 2.56 Nepalese rupee**.
- [3] This **impact is materialized within** a reasonable amount of time (**1.5 year**).
- [4] The **expansionary effects of social protection expenditures** on GDP **exceed** in magnitude those of **current Government expenditures**.
- [5] Therefore, **economic growth and redistribution** can be jointly **achieved** by **increasing the social protection component** of Government expenditure in Nepal.

### Introduction

This policy brief focuses on the central role of social protection in boosting Nepal's economic growth in an inclusive and sustainable way. It aims to summarise the results, conclusions and recommendations stemming from the research paper "Multipliers of Social Protection -- Nepal country case study".

In addition to the immediate effect of boosting aggregate demand through increases in household consumption, investment in social protection is an effective tool for reducing poverty and inequality, thus enhancing political stability. Given that income inequality keeps the economy from functioning at its full capacity, this policy brief argues that Government investment in social protection can significantly promote economic growth in Nepal. Income security reduces child labor and promotes a significant boost in educational attainment and entrepreneurship. Social protection generates access to full employment and decent work conditions for all, including women and young people. It also provides better access to food and enhanced

nutritional status, and leads to better and more equitable health outcomes.



In Nepal, the Constitution of 2015 recognizes social security as a right to all citizens, explicitly stated in Article 43. Yet, there is still a long way to go for a more comprehensive coverage, as evidenced for example by the following facts:

- Only 16.9 percent of the population in Nepal is covered by at least one social protection benefit, against a world average of 47 percent.
- The Child Grant program has low coverage: only a third of children up to 5 years old receive the benefit.

Furthermore, the COVID-19 crisis was especially harmful to informal workers and highlighted existing inequalities. The Russian-Ukrainian war that followed has brought new challenges by contributing to a significant rise in inflation.

In this context, the following questions naturally arise:

- Can Government investment in social protection boost Nepal's economy and, if so, by how much?
- Do expenditures in social protection exert a larger or smaller positive impact on economic activity than total Government expenditures?



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## Findings

To answer the above questions, the country case study used data for Nepal from 2005 to 2018. The main findings of the econometric analysis are summarised in Table 1.

### ► Effects of Social Protection Investment on GDP

Total social protection investment has a positive impact on Nepal's real GDP. Specifically, an increase of 1 Nepalese rupee in social protection expenditures leads to an increase of 2.56 Nepalese rupee in GDP after 1.5 year (see Table 1). Similarly, a cumulative increase of 1 Nepalese rupee in social protection expenditures over 2.5 years leads to an accumulated effect on GDP, which amounts to an increase of 2.62 Nepalese rupee (see Table 1). It is important to emphasize that the estimated fiscal multipliers are larger than one. This implies that one additional Nepalese rupee of social protection expenditures increases real GDP by more than one Nepalese rupees. Thus, the results suggest that an increase in social protection investment by the Government can lead to a substantial boost of economic activity in Nepal.

### ► Effects of Current Government Expenditures on GDP

Current Government expenditures also have a positive impact on Nepal's real GDP, but the effect is found to be smaller than in the case of social protection expenditures. Specifically, an increase of 1 Nepalese rupee in current Government expenditures leads, after 0.5 year, to a GDP increase of 0.45 Nepalese rupee (see Table 1). Similarly, the accumulated effect on GDP after 2.5 years amounts to an increase of 0.56 Nepalese rupee (see Table 1). In conclusion, one additional Nepalese rupee of current Government expenditures increases real GDP by less than one Nepalese rupee.

Therefore, the positive effects of social protection expenditures on Nepal's GDP exceed in magnitude those of current Government expenditures. Specifically, they are more than 5 times larger than the effect found for current Government expenditures. This result provides strong evidence in favor of the relevance of social protection expenditures for Nepal's economic growth.

► **Table 1: Estimated fiscal multipliers for Nepal**

Expenditure Category	Impact	Peak	Accumulated (over 2.5 years)
Social protection expenditures	0.72	2.56 (after 1.5 year)	2.62
Current Government expenditures	0.20	0.45 (after 0.5 year)	0.56



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## Policy Implications

The main policy implications are summarised below.

- [1] The economic returns from social protection investment in Nepal are substantial.
- [2] An increase of 1 Nepalese rupee in social protection expenditures leads to an increase of 2.56 Nepalese rupee in GDP.
- [3] This impact is materialised within a reasonable amount of time (1.5 year).
- [4] The positive effects of social protection expenditures on Nepal's GDP exceed in magnitude those of current Government expenditures.
- [5] Economic growth and redistribution aiming at lowering inequality can be jointly achieved by increasing the social protection component of Government expenditure.

Overall enhancing social protection should not be a disconnected policy from the general development strategy and the goal of sustaining inclusive growth. In fact, the multipliers estimated for the present country case

study indicate that building vigorous social protection systems has a potential to unleash a virtuous economic dynamic in which higher expenditures in social protection lead to higher income, employment rates and tax revenues. A growth process that reduces inequalities necessitates a social protection system.

In light of these results, discussions at a broader political level, should consider investments in social protection as part of the key engines of growth.

At the **micro level**, social protection can enhance growth directly and indirectly, through the following channels:

- preventing the loss of productive capital;
- accumulating productive assets and increasing access to labor markets;
- increasing innovation and risk taking; and,
- increasing investment in human capital.

At the **macro level**, social protection can enhance growth by:

- increasing household productivity and employment;
- aggregate demand;
- facilitating economic reforms;
- building human capital;
- contributing to social cohesion and equality; and,
- influencing demographics (through impacts on fertility rates).



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## Conclusion

Social protection is at the forefront of the development agenda and is one of the priorities for the Government of Nepal. While there are some discussions on the linkages between social protection coverage and economic development in the country amongst key stakeholders, lack of evidence on the relationship between social protection expenditures, inclusive economic growth and macroeconomic stability has prevented a more explicit discourse.

**The country case study for Nepal highlights the importance of public investment in social protection.**

The results presented are encouraging for policymakers and analysts who should participate in social dialogues, incorporating all stakeholders involved in developing and enhancing social protection systems, to argue in favor of the relevance of social protection for achieving sustainable and inclusive economic growth. **A key policy message is that increased social protection expenditure in the past decade and limited fiscal space currently should not hinder expansion of social protection coverage in the coming years.**

These results become even more important in the aftermath of the economic crisis resulting from the COVID-19 pandemic, which has affected disproportionately the poor population and has highlighted the challenges that arise from the prevalence of informal employment. This is a valuable opportunity for Nepal to echo the global work in this critical issue as social protection reforms are being implemented in the context of the COVID-19 recovery.

An interesting **extension of this work** would be **to explore the impacts of the social protection expenditures on the variables that aim to capture inclusive social development in Nepal.** For example, studies that explore the direct effects of social protection on poverty reduction, income inequality and educational attainment seem to be a way forward. Would more disaggregated data be available, another interesting avenue of future research would be to look at local (e.g., at the province level) fiscal multipliers. Finally, increasing the frequency of available data for social protection expenditures from annual to quarterly would enable economists and policy analysts in the future to obtain improved econometric estimates of the impact on real GDP and on other variables of interest.



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