Sideswiping the State:
Social Funds and the Future of Health, Education and Water Services

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Argument Summary

The Social Fund represents a fundamentally new paradigm in rural and community development. As this paper argues, this new approach to development threatens to put governments out of the business of providing basic services – health, education and water -- to their citizens. Even more troubling, the Social Fund model retains and even amplifies familiar aid program flaws that deny benefits to the poorest, while rewarding those stakeholders with the best social and political connections.

The World Bank touts Social Funds as a "Demand Responsive Approach" as an alternative to traditional lending, which was driven by Washington's endless supply of development fads. It claims that, as an innovative aid mechanism, Social Funds can respond to local demand by delivering, pro-poor, community-centered projects created and implemented by poor communities themselves.

A. Description and Rationale of Social Funds

In February 2002, the World Bank's Board of Directors approved a Private Sector Development (PSD) Strategy that aims to expedite the privatization of basic services – health, education and water – in borrowing countries. The Bank paper "Private Sector Development: Activities of the World Bank Group" (May 2001) identifies several categories of PSD operations: in addition to privatization of public enterprises and programs to stimulate business activity, it advocates the use of Social Funds.

Originally designed as a mechanism for imparting disaster relief, Social Funds typically channel external aid through quasi-government agencies (either provincial or federal) that obtain resources from the World Bank and other aid agencies, and subsequently disperse them directly to communities. Social Funds often contain thousands of sub-projects, *all of which are carried out by private (including non-profit) contractors*. The majority of Social Funds require that governments delegate infrastructure construction and service provision to communities. Importantly, *few Social Funds allow governments to bid on service contracts*. The most direct beneficiaries of this transfer of responsibilities – those who receive cash payments from Social Fund resources – include private firms and service-oriented NGOs.

While Social Fund lending now makes up a small percentage of the Bank's overall portfolio, Social Funds can represent a major investment within a given country. For example, in Ethiopia, 40% of all rural water services are delivered through the Social Fund mechanism. The Bank has channeled \$3.7 billion to Social Funds in 57 countries – primarily to finance health, education and water infrastructure and services. With donor and government co-financing included, the total is about \$9 billion. Social Fund agencies may become increasingly important as donors and creditors seek to channel resources directly to private and NGO service providers. For example, private service provision is likely to be a key objective of the Millennium Challenge Account (MCA), a bilateral aid program that will be launched by the U.S. government in 2003.

One of the main attractions of Social Funds is their "demand responsive" nature. Under the Social Fund model, international bureaucrats with little country experience do not draw up complex development programs in their shiny Washington DC offices. Rather, community stakeholders themselves propose and design projects that they implement. The World Bank's "Demand-Responsive Approach" to Water Services is summarized as follows:[1]

- The focus is on what users want, are willing to pay, and can sustain.
- The local community initiates, plans, implements, maintains and owns the system (increasing its sense of responsibility;
- Water is treated as an economic good.
- The private sector provides goods and services.
- Local water committees, in which women play a key role, are strong (but need training).
- Full cost recovery is expected on O&M and replacement.
- *The more users pay, the more likely a project is to be demand-driven*. (Emphasis added.)

Social Funds have been justified as an appropriate response to the (perceived) failure of the state. Service provision in much of the developing world excludes the poor. For example, it is estimated that around the world, nearly one-sixth of the population, one billion people, lacks access to treated water.[2] Among this group, thousands die every year from preventable water borne diseases. Although the World Bank and other multilateral and bilateral lending institutions have spent billions of dollars over the past 50 years, the results of this spending have been disappointing.

Those who run these developmental institutions attribute this poor performance to a failure of the public sector. Since most of the assistance from the World Bank and other institutions has been channeled through public sectors, they have simply concluded that insufficient progress in achieving access to basic services is due to inherent weaknesses of the state: political interference, blatant corruption, or incompetence. This position is often presented anecdotally by World Bank staff members who have worked in developing countries on investment projects: "I saw with my own eyes how corrupt the public sector is. It is unlikely that there can be real development in the context of a public infrastructure with leakages at every level."

Public sector weakness and corruption do exist. But the argument that identifies the public sector as the root cause of service provision failure is invalid. The task of debunking this argument in detail has been taken up elsewhere.[3] For present purposes, it should be noted that the conclusion of governmental inadequacy leads to the following needs, all of which the Social Fund mechanism is claimed to address.

[1] Adapted from World Bank OED, "Rural Water Projects: Lessons Learned," *Precis* Number 215, Winter 2002.
[2] United Nations Environment Program, *Global Environment Report, 2000* .
[3] See for example, Hall, "Water in Public Hands: Public Sector Water Management, a Necessary Option", London, University of Greenwich, 2001; Arthur Goldsmith. 1999. "Africa's Overgrown State Reconsidered: Bureaucracy and Economic Growth." *World Politics*, Vol. 51.

1) The need for non-corrupt service providers.
2) The need for pro-poor service providing instruments.
3) The need for accountable service providers

B. Performance of Social Funds

Because Social Funds are emerging as increasingly important part of global aid strategy, it is essential to assess their effectiveness in promoting developmental or poverty reduction objectives. This section summarizes evidence and analysis that suggest that calls for expanding Social Funds cannot be justified by their mediocre performance.

1. Impact on Government Capacity

Social Funds reduce red tape. But in the process, they can also reduce government capacity and accountability. Because Social Funds bypass government bureaucracy and regulation, the Bank can tout fast disbursement with a minimum of bureaucratic oversight. Indeed, Social Funds have provided needed assistance in conflict and disaster-ridden countries. However, in countries with more routine development challenges, there is often a high price for such administrative "efficiency."

Social Fund programs are often implemented in parallel with government programs, undermining overall coordination of investment efforts. When parliaments authorize Social Funds, they typically do not know how money will be spent. (Indeed, the point of Social Funds is to circumvent their central authority) Even line ministries are typically ignorant of Social Fund activities**.** Lack of information about Social Fund activities *undermines the capacity of governments to plan and implement development programs* – especially in the health, education and water sectors. The Bank's own evaluators are concerned about the impact of this practice:

> Project documentation indicates that relatively little attention has been paid in Social Fund projects to the impact of Social Funds within the overall framework of public expenditure planning, or to compliance with national budget and accounting requirements, although large Social funds may upset the transparency, accountability and comprehensiveness of the budget process.[4]

The OED study also shows that Social Funds often "have had negative institutional effects for public planning processes and budget accountability", especially when the Social Fund "disbursements have accounted for a significant share of public expenditure."[5] In other words, the larger the Social Fund, the more likely it will have a negative impact on government budget allocation processes. For example, in Zambia, an education Social Fund allocated 70 per cent of its resources to schools. According to the OED, while the Social Fund has had success in building and repairing schools and even to some extent training teachers, "in substituting for some functions of central and local officials, it has tended to inhibit development of the permanent

[4] OED, *Social Funds: Assesing Effectiveness*, World Bank, 2002., p. 36.
[5] OED 2002, p.xi

institutional capacity and accountability structures needed for sustainable sectorwide improvements."[6]

In many countries, citizens' groups are participating in the creation of poverty reduction strategies. Indeed, the initiative for Highly Indebted Poor Countries (HIPC) tracks expenditures to help ensure that resources made available through debt reduction are mobilized for productive or socially progressive purposes. Ironically, the World Bank, a midwife of poverty reduction strategies, encourages rational and transparent budget processes at the same time that promotes Social Funds, which can reduce the capacity of government to provide, or even have access to information necessary for achieving that goal.

Social Funds can undermine public governance in two other ways that are worth noting. First, Social Fund projects can directly drain away overall government capacity through "headhunting." According to a senior World Bank economist, "Social funds poach staff from existing agencies and pay significantly higher wages, thus creating unmanageable tensions and resentments with existing public sector staff."[7]

Second, the ambiguous quasi-governmental status of Social Fund projects may preclude government oversight or even adherence to internal bank policies. For instance, Social Fund water related sub-projects do not come under the Bank's water supply and sanitation or irrigation portfolios. Therefore, they need not adhere to Bank guidelines that pertain to those sectors. While red-tape critics may applaud what they regard as "streamlining," the implications of unsupervised project implementation by inexperienced local authorities may have serious consequences for governance and even public health.

2. Impact on poverty reduction

Because Social Funds may contain thousands of sub-projects, it is difficult to measure their impact. Moreover, the most comprehensive study that has addressed the question relied on incomplete data. Of the 23 Social Funds completed as of the end of 2000, less than one quarter responded to a comprehensive OED survey. However, what little is known about Social Funds' poverty reduction effectiveness is cause for skepticism.

As the OED report indicates[8], most principal welfare indicators did not differ between Social Fund communities and a control group. Among those that did differ, there was a roughly even distribution between negative impacts and positive impacts. In sum, there is no evidence that Social Funds are more effective in reducing poverty than any other community financing mechanism. Indeed, the evidence presented by OED indicates that non-poor communities are more likely to benefit from a Social Fund than the poor.[9]

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[6] William Battaile, OED, *2001 Annual Review of Development Effectiveness: Making Choices*, World Bank, 2002.
[7] Ellerman, "What's Wrong with Social Funds?" in "Working on Administrative and Civil Service Reform," World Bank, November 2001.
[8] See OED 2002, pp.75-78, and annex E2
[9] For example, see OED 2002, p.92, on the benefits to the non-poor.

The performance of Social Funds in providing jobs is revealing. A central reason for the establishment of Social Funds in countries undergoing severe recession due to austerity or natural disaster has been to provide employment. However they have failed to significantly stimulate employment and "reached only a small fraction of the labor force (in the Latin American case, less than one percent at best)."[10] Furthermore, because Social Funds are run by small private sector actors and often employ part time or contractual labor, they may undermine public sector unionization efforts that are crucial for improving the lives of the working poor.[11]

The OED report also concludes that only 43% of Social Fund operations surveyed was sustainable – meaning that they could continue to provide benefits after aid resources had been dispersed. Among services sectors, water and sanitation fared especially poorly, with only a quarter of sub-projects rated sustainable, far worse than education or health sub-projects. Remarkably, In spite of these poverty outcomes and sustainability ratings, the Bank claims that Social Fund projects are *96% satisfactory* at completion![12]

As troubling as the low rate of sustainability is the Bank's basis for defining it: projects are often deemed sustainable when they demonstrate effective cost recovery. Ominously, the Bank has declared: "The more users pay, the more likely a project is to be demand-driven."[13] While it is true that spending a higher proportion of one's income on a particular service indicates the importance of that service, this economic fact of life is not a justification to raise rates. For the third of the world's population that subsists on less than two dollars a day, raising the price of essential services will either lead to exclusion from service provision, reduced consumption of other basic goods and services, or both. In the case of water, many may be forced to consume untreated water, and endure consequences such as a rise in preventable disease.

C. Explaining the Disappointing Performance of Social Funds

Available evidence on the performance of Social Funds, while limited, begs the question: Why haven't they lived up to their promise? As this section describes, the invention of the Social Fund mechanism has done nothing to address two basic constraints facing any development program: politics and limited resources.

1. Politics

Social Funds may be re-shaping the way that international aid is disbursed, but they haven't changed the rules of national politics. Though decentralization is claimed to be a driving force

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[10] Tendler and Sorrano, *The Rise of Social Funds: What are they a model of?*, 1999? unpublished, section 2A. It is revealing that recent World Bank documents barely mention this original justification for Social Funds. See Steen Jorgensen, "Social Funds", (Power Point Presentation), 1999, p.10.

[11] Tendler writes of the Latin American examples: "Jobs offered by the Social Funds were temporary, of low quality, and provided little or no training. Most of the better jobs went to skilled laborers brought in from elsewhere by outside contractors; skilled labor, for example, accounted for 42 per cent of labor expenditures in the Nicaraguan Social Fund." Tendler, "Why are Social Funds so Popular?" in Yusuf and Evenett eds., *Local Dynamics in an Era of Globalization: 21st Century Catalysts for Development*, World Bank, 2000, p.116.

[12] OED 2002, p.xxvi.

[13] OED, "Rural Water Projects: Lessons Learned," Precis Number 215, Winter 2002. Emphasis added.

behind Social Funds, the local administering agency is typically accountable to a centralized (either state or federal) government agency.

One obvious problem with the persistence of local-national hierarchies is the potential for expand patronage opportunities: The national political establishment can treat Social Funds like a slush fund to support communities whose political support it seeks to win or retain (e.g., just before an election, to create jobs in communities that support political rivals). According to political scientist Judith Tendler:

> Anyone visiting a SIF director in Brazil will find his outer office stuffed with local politicians waiting their turn . . . mayors, state legislators, ward bosses. Many of these visitors (or those calling by phone) are asking the same thing. Why hasn't my project been approved yet, and when will it be? . . A variation on this drama takes place in the governor's office . . . The complaints have a clear bottom line, whether spoken or not: I delivered for you (or your candidate) in the last election, what are you doing for me? Or, I supported your unpopular proposal in the state assembly last month, so why aren't you coming through for me? These waiting-room images and the political questioning behind them contrast distinctly with the image of the donor narratives, in which rather autonomous and private-sector-like Social Fund managers work refreshingly free of these kinds of entanglements.[14]

Politics can determine not only where a particular Social Fund might take place, but also how and to whom contracts are delivered. Those who know about the existence and operation of the Social Fund are most likely to be those with connections to the administering body. The reality of political connections works against the progressive mandate of Social Funds. When "demand driven" projects are exposed to the real world of personal connections, bribes and vote-buying, they fall into the hands of socially priveleged people who are unlikely to select interventions that benefit primarily poor or marginalize community members.[15] Even in cases where the Bank claims that Social Funds are living up to their redistributive mandate, richer groups may receive as much as two and a half times as many benefits as poorer groups.[16]

The political dimension of Social Funds is actually one of their defining characteristic. Social Funds are less likely to be driven by the demands of communities for services than by the demands of construction companies for contracts, the demands of politicians to be reelected, and so on. Tendler claims that this feature of Social Funds transforms a so-called demand-driven model into a new kind of supply- driven model: Instead of bureaucrats pushing money across the table, contractors and equipment suppliers work with willing politicians to supply their services to communities whose need for them is questionable.[17]

Even their main cheerleaders have conceded that instead of being community driven, Social Funds are often driven by a few community leaders, or what the World Bank calls "prime movers".[18] Factors like articulateness, leadership role, (and implicitly related characteristics such as social status, race, class and gender) have as much to do with who receives Social Fund sub-

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[14] Tendler, unpublished, p.68.
[15] Mcleod and Tovo, *Social Services Delivery through Community-Based Projects*, World Bank, 2001 p 70.
[16] See Tendler 2000, p.116 for details
[17] Tendler 2000, p.118
[18] OED 2002, p.xxvii

contracts as the needs of the community. This conclusion suggests that Social Funds can be used as a decentralized form of "welfare for the better off."[19] The Bank's evaluators produced evidence substantiating this view: *only 27%* of respondents felt that Social Funds addressed their top priority concern, while only 43% felt that Social Funds addressed even one of the top three community priorities.[20]

2. Sustaining Commitments with Scarce Resources

A further problem of Social Funds has been the sustainability of projects when they require more than a single, lump sum investment. For example, schools and hospitals require routine resources for staff salaries, maintenance, textbooks, and supplies; financing for such recurrent costs has proved difficult to maintain through the Social Fund mechanism. However, according to the bottom-up theory of Social Funds, "the demand driven features of the Social Fund should have led inexorably to ownership of the new project by communities, who would have willingly taken responsibility for operations and maintenance themselves or successfully pressured local governments to do so."[21]

Unfortunately, Social Funds create neither more central government revenue, nor greater willingness within communities to use local resources for local needs. Anticipated "bottom-up leadership" has not been forthcoming, calling into question the ownership and community priorities that are supposed to justify Social Fund projects. In fact, the Social Fund mechanism can act as a disincentive to create sustainable operations and infrastructure.

Social Funds can undercut sustainability because their external resources (temporarily) replace tax revenue that would normally be required to make investments in communities. The work of "mainstreaming" Social Fund projects would therefore involve allocating new revenue streams within various line ministries, which already function with a severely limited budget. However, in the absence of a specific mandate from the executive, is not in the interests of the line ministry to "mainstream" the Social Fund operation, as this would inevitably involve further expenditure and put pressure on existing programs.

D. Conclusion and Recommendations

Nearly all Social Funds create processes that are intended to replicate the responsibilities of good governments. However, they do not – and cannot – create the democratic, transparent and accountable institutions necessary to carry out those responsibilities. Social Fund agencies, some of which were established to help disaster-stricken governments with weakened capacity, may have the effect of further weakening government capacity to develop accountable and effective mechanisms for delivering services to its citizens.

In light of the evidence of the failure of Social Funds, we recommend that — except in cases of disaster relief -- Social Fund resources for projects should be phased out and reinvested in line ministries or other accountable government bodies. Until this is possible, all Social Fund

[19] See Tendler, unpublished for more details.
[20] OED 2002 Annex M, Table M1
[21] Tendler, 2000, p.117

Projects should be re-designed to allow participation by governments in service provision so that they are not excluded from contracts to provide essential services.