The Role of Social Protection within a Social Market Economy

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Social protection refers to the entire system of protective measures that assist individuals, households, and communities to better manage risks and economic shocks and that provide support to the critically vulnerable. Among the major risks covered are illness, accident, death, unemployment, or old age. Social protection includes public as well as private approaches.

Insufficient social protection can have a disastrous effect and impoverish people – or drive them deeper into poverty. However, especially in developing countries, the majority of people do not have adequate social protection coverage.

Improving social protection coverage has the potential to contribute to poverty reduction in many ways: Social protection *protects* individuals from the adverse financial consequences of the above mentioned calamities. It thus prevents people from becoming poor or falling deeper into poverty (protection function). In addition, social protection entails an income generating effect and reduces prevailing poverty by *enabling* productive investments in human capital (investment function). For example, social health protection allows individuals to invest in health by facilitating access to health services. Another example are cash transfers, a form of basic social protection, which help to break the vicious intergenerational cycle of poverty by improving the health and nutritional status as well as education level of beneficiaries, thereby increasing the likelihood of better future employment opportunities for children. By reducing the existential fears of members of society, social protection policy encourages individuals to take risks which otherwise they would not be willing to take, like investing in new business opportunities. Further important benefits of social protection accrue from a reduction in the use of inefficient risk-coping methods like selling productive assets or taking children out of school. Finally, mutual protection against social risks strengthens the bonds of cooperation and reciprocity, thereby enhancing social stability and social cohesion.

A system for social protection is inevitably linked to the concept of a social market economy. The social market economy aims to achieve a synthesis between efficiency and equity by combining the efficiency gains of a free market economy with a publicly induced social balance. In this context, the constituent feature of a social market economy is the complementary character of two distinct orders: the economic and the social order. The economic order provides the institutional framework for a free market economy (including, for example, private property rights, competition policies). It emphasizes the individual responsibility of all members of a society, who participate in society's wealth according to their individual contributions to its creation. The economic order is complemented by the social order. The provisions of the social order are oriented towards the needs of society's members and also attempt to provide equal opportunity. Besides solidarity with the needy, the principle of individual responsibility justifies only subsidiary public action. A system of social protection forms an integral component of the social order.

Subsidiarity, which combines individual effort and self-responsibility with collective (societal) support guided by solidarity, is the overarching principle of the social market economy. This major principle is also reflected in the setup of social protection within a social market economy: generally speaking, provisions against risks should always be the responsibility of the most basic unit possible, ranging from the individual and the family up to the different levels of the state.

Social protection within a social market economy is usually characterized by the so-called "social state model." Within the social state model, social protection is based on (a) statutory social security comprising the key social insurances, including health insurance, old age insurance, unemployment benefits, work injury insurance, long-term care, and disability benefits (mainly contribution financed); and (b) complementary means-tested social assistance, meaning residual economic or social support for poor and needy individuals or vulnerable groups of society, which is financed by taxes.[1]

Social insurance is the major pillar of social protection within the social state model. Self-responsibility is reflected by the fact that membership relies on individual contributions/payments; solidarity, in turn, is incorporated by either

[1]The social state model is one of the two main approaches to public social protection. The second approach is commonly denoted by the welfare state model, in which comprehensive social protection against existential risks is primarily based on universal provision of public care financed by taxes and, only to a lesser extent, contribution-based. Some non-targeted tax-financed elements of the welfare state model are often also taken up by societies where social protection is primarily organized via the social state model (for example, family or housing benefits). The main difference between the two approaches is the relative weight they assign to individual and societal responsibility: the social state model stresses the primacy of individual responsibility and subsidiary societal support, whereas the welfare state model particularly emphasizes societal responsibility.

income-related contributions (considering the individual ability to pay) and/or an at least partial de-linking of the size of benefits from the level of individual contribution paid, thus involving a redistributive effect. The shared financing of contributions by employees and employers is another expression of solidarity. On the provider side, subsidiarity is reflected by the principle of self-administration: insurance funds are self-governing corporations under public law. Public social assistance is essentially subsidiary assistance which is principally provided as a "measure of last resort" to the most needy groups within a society. It enables all eligible persons to live a life in accordance with human dignity. At the same time, social assistance does not aim at simply providing a form of alimentation, but rather it pursues the objective of strengthening people's self-help capacities. In addition, providing incentives for promoting private social protection forms another important component. Last but not least, public social protection measures should be tied to the economic capacity of a society in order to guarantee their sustainability.

Social protection is on the political agenda in many low- and middle-income countries. However, the objective is not and should not be to simply "transplant" concepts from high-income countries. Rather, tailor-made solutions adapted to specific national contexts need to be developed. This involves taking the specific characteristics of these countries and their impact on social protection into consideration while developing a social protection system. Among those characteristics are, for example, low coverage and fragmentation of existing systems, restricted contributory capacities and impaired tax systems, large informal labor markets, and confined administrative capacities. In this context, technical challenges for national policy makers and for development cooperation include the following:

- defining an "optimal benefits package" that provides adequate protection but is financially sustainable;
- developing approaches that fit prevailing labor market characteristics in developing countries, where labor markets are often characterized by a high percentage of informal sector activities; and
- linking access to social protection with quality improvements in service delivery.