



# Safety Nets Primer Notes

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## Reducing Error, Fraud and Corruption (EFC) in Social Protection Programs

Because Social Protection (SP) and Social Safety Net (SSN) programs channel a large amount of public resources, it is important to make sure that these reach the intended beneficiaries. Error, fraud or corruption (EFC) reduces the economic efficiency of these interventions by decreasing the amount of money that goes to the intended beneficiaries, and erodes the political support for the program. While no program is immune to EFC, evidence from developed countries demonstrates that such leakage can be brought to negligible levels. In five OECD countries this fraction is between 2-5% for the SP sector as a whole. For SSN programs, which use more complex eligibility criteria and hence are more prone to EFC, this fraction is 10%. To achieve these results, programs have implemented a number of measures reviewed in this note. In contrast, efforts to combat or even measure EFC are quite rare in developing countries, although some programs are plagued by it.

**Definitions.** Although most SP programs strive to transfer all their resources to the *right beneficiaries, in the right amount and at the right time*, a fraction is lost to EFC (Figure 1):

- *Error* is the unintentional violation of program or benefit rules, resulting in the wrong benefit amount or payments to an ineligible applicant. One can distinguish between *official error* due to staff mistakes, and *customer error* which occurs when a customer inadvertently provides incorrect information.

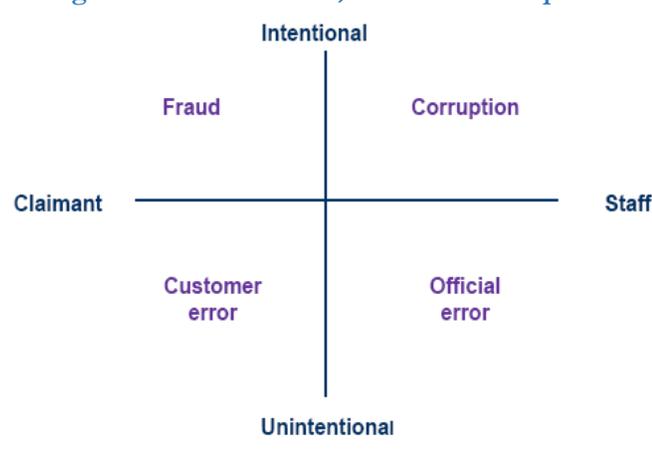
- We refer to intentional abuses of the program by claimants as fraud and by staff as corruption. *Fraud* occurs when a claimant deliberately makes a false statement, conceals or distorts relevant information regarding program eligibility or level of benefits. *Corruption* commonly involves manipulation of beneficiary rosters (e.g. registering potential beneficiaries for clientelistic purposes to garner political support); staff accepting illegal payments from legal or illegal beneficiaries; or diversion of funds to ghost or illegal channels.

### Opportunity cost of fraud and error in the UK social protection system

In 2005, social protection spending represented a quarter of the total public spending in the United Kingdom. About \$220 billion in benefits have been paid to 17 million beneficiaries. About 2.5% of this amount, or \$5 billion, was lost to fraud and error. If saved, these resources could have been used to provide 32,000 more doctors, or 80,000 nurses, or 72,000 teachers, or 62,500 police officers.

Source: DWP (2005)

**Figure 1. What are error, fraud and corruption?**



**Why do we care about EFC in SP programs?** SP programs channel a large amount of public resources to targeted beneficiaries, and even a small fraction of misappropriated benefits may add up to large sums of money with high opportunity costs. On average, SP spending represents 15.7% of GDP in developed countries, 7.4% in middle-income countries (MICs) and 3.8% in low-income countries (LICs). Within SP, this topic is more relevant for programs with complex eligibility requirements which make them more prone to EFC, such as social safety nets, disability insurance or unemployment supports. Spending for these programs averages 6% of GDP in developed countries, 3% in middle-income countries and about one percent of GDP in low-income countries. Ensuring that these resources reach the intended beneficiaries will determine the efficiency of public resources as well as the reputation and credibility of the program, and ultimately the support for the program.

**How much is lost to EFC?** There is very limited evidence in this respect, most of it from developed countries. A recent study (NAO, 2006) found that fraud and error rates are positive even in well-run programs operating in high-capacity countries. In five OECD countries – the UK, Canada, Ireland, New Zealand and the USA – fraud and error rates ranged between 2% and 5% for the whole SP system (Table 1). Within the SP system, means-tested SSN programs had the highest fraud and error rates (5-10%), followed by

unemployment benefit and disability pension programs (1-2%); old-age pensions had the lowest rates (0.1-1%). These figures should be interpreted as good-practice, or as lower bounds for the amount of funds affected by EFC, as they come from a small sample of countries and programs with high administrative capacity, with adequate procedures to minimize EFC, including procedures for estimating the level of fraud and error with reasonable accuracy.

**Table 1. A Comparison of Fraud and Error Rates in 5 OECD Countries <sup>1</sup>**

As % of expenditure/payments	UK	Canada	Ireland	New Zealand	USA
	(2004-2005)	(1994, 2003)	(2004)	(2001)	(2003)
<b>Total Fraud and Error</b>	2.3%	3-5% ('94)	-	2.7%	-
<b>Fraud and Error in Housing Benefit</b>	5.2%	-	-	-	3.6%
<b>Fraud and Error in Income Support</b>	5.3%	3.5% ('03)	-	-	5.07%
<b>Fraud and Error Old Age, Disability</b>	4.9%, 0.1%, 1.9% <sup>2</sup>	-	7%	-	0.53%

Source: NAO (2006)

Notes:

<sup>1</sup> Comparisons are difficult as benefit types differ between countries. This table shows rates for the following benefits. The Income Support benefit for Canada and the US is Unemployment Insurance. In the category, Old Age and Disability, the benefit in Ireland is Disability Allowance and in the US Old Age, Survivors and Disability. Also measurements vary. Rates for the UK refer to fraud and error as % of total expenditure. Rates for Canada ('03) refer to the total savings identified as a percentage of total payments. Ireland measures fraud and error as a percentage of expenditure for specific benefit types. New Zealand estimates this percentage as the number of cases sampled that contained errors, which led to benefits being paid incorrectly. The USA measures the total value of improper payments per benefit type.

<sup>2</sup> These rates are for Pension Credit, Retirement Pension, and Disability Living Allowance respectively.

The information from developing countries is scarcer, as only few programs and countries have taken measures to combat and/or measure the incidence of EFC. However, it is plausible to expect the share of funds affected by EFC be larger compared to developed countries. For example, in India a Government audit in 2003 found that 31.6% of IAY (housing programs) and 53.5% of SGSY (credit program) funds did not reach the intended beneficiaries. In the case of the SGRY, an employment program, administrative data report that 31.3 million man-days of work were generated in 2001-02, while the National Sample Survey data for 2002-03 estimate this number as less than 3 million man-days, only 10% of the official figure.

Three points can be made about EFC in developed and developing countries:

(1) Across SP programs, the share of funds affected by EFC is larger in SSN programs, due to their inherent design features. Eligibility for these programs is often based on the economic position of the household, which is more difficult to assess and harder to verify than, for example, for an old-age pension where all you need is proof of past contribution and age. Because SSN programs are more narrowly targeted to poorer households and poverty status changes over time, eligibility also changes over time. The responsibilities for implementing SSN programs are often shared across different departments, agencies, and levels of

government. All these factors increase the risk that benefits do not reach intended beneficiaries in time or in the correct amount. Having the right instruments and tools to minimize EFC is thus more important for SSN programs, although there are economies of scale when the efforts to combat EFC cover the whole set of SP programs.

- (2) The level of EFC is likely correlated with the institutional capacity of the country and implementing agency. One would expect to find more EFC in LICs and MICs than developed countries. However, evidence is scarce as very few programs or countries measure the level of EFC using comprehensive, unbiased measurement tools (see Box 1).
- (3) In developed countries there is a much greater concern about error and fraud, while developing countries worry more about corruption. For example, none of the 9 OECD countries reviewed in NAO (2006) explicitly reported issues around corruption of departmental staff. It seems a small problem for administrators in these countries. Reasons could include a strict separation of functions (e.g. between payments and assessments, between decision-making and investigations and reviews), staff training and management, effectiveness of internal audit and the integrity of systems processing payments. In contrast, corruption is often the lead concern in developing countries.

## Box 1. How can programs measure the level of error and fraud?

### *Lessons from developed countries*

Measuring fraud and error in the SP system is difficult, but not impossible. There are different measurement approaches, used primarily in developed countries:

- **Total fraud and error in the SP system.** Although complex, this methodology generates an unbiased representative estimate of the level of fraud and error in the program. This level may be expressed as % of program funds affected by error and fraud, or the number of cases, or both. To arrive at this estimate, a representative sample of cases (client files) is drawn from the active caseload. The program will provide the (electronic and written) records to a review team that would check each case for mistakes or inaccuracies in the data and, where appropriate, would visit and re-interview the applicant. For each case, the review team will estimate the amount of money under and over paid, and whether the difference is due to error or fraud. These figures are summed up to estimate the total level of error and fraud. These estimates are qualified by confidence intervals that take into account the fact that a relatively small sample is used in relation to the size of the actual caseload. Few countries measure the level of total fraud and error across SP programs. From the nine countries reviewed in the NAO study (2006), only Australia, Ireland and the UK measure overall level of fraud and error on the basis of ‘rolling measurement’ and/or ‘snapshots’. This is considered as gold standard.
- **Level of fraud and error in specific programs.** Some countries measure the level of fraud and error based on a thorough review of a random sample of beneficiaries files (Sweden, US, and New Zealand); others link their sampling and reviews to risk-based assessments (Ireland and US).
- In many cases measuring focuses on **other criteria than the total number of cases, and the total value of fraud and error**, leading to a partial and non-comparable estimate of the level of error and fraud in the system. These criteria include: (i) **Minimal accuracy targets** (New Zealand, Sweden, Australia): These measurements focus on the proportion of accurate decisions to pay benefits and the proportion of accurate payments being made. (ii) **Totality of improper payments per benefit type** (USA): This is a measurement of the total amount of improper payments per benefit type, which lumps together fraud and error. There is no system-wide aggregation of the total value of improper payments. (iii) **Savings and prosecutions achieved** (Australia, Ireland, the Netherlands, and New Zealand): This measurement focuses on savings, performance and also prosecutions, based on observations and outcomes of reviewed cases. (iv) **Sampling in specific benefit schemes** (Ireland and USA): Measurements are targeted on specific benefit schemes, which are perceived at high risk from fraudulent claims.

*Source: based on NAO (2006)*

**What can be done to reduce EFC?** No program is immune from error or even some degree of fraud and/or corruption, but having solid mechanisms, procedures and institutions to prevent, detect, deter and measure EFC helps. Some of these mechanisms or institutions are not specific to the SP sector or the particular program. For example, implementing a broad government-wide governance agenda of due process, transparency and accountability will reduce the level of funds affected by EFC. A good practice, common in many countries, is to subject SP programs to the regular oversight and control of the supreme audit institution and/or the public prosecutor’s office. These institutions also act in case of allegations.

At program level, the level of EFC can be reduced through careful program design and consideration of the specific institutional context and administrative setting. Some of the measures are:

1. **Using program design to minimize incentives and opportunities for EFC.** The specific design features include: making program budgets consistent with eligibility criteria to eliminate opportunities for bribery; centralizing the determination of eligibility (when program implementation is decentralized) and defining simple eligibility criteria to reduce discretion and opportunity for corruption; considering the benefit level

for a participant with respect to the salary of the intake officers to make less attractive the possibility that an ineligible applicant may offer a cut of her/his benefit in return for entrance into the program; defining conditionalities such as requirements for recipients to get health care, attend school, or work to guard against ‘ghost’ beneficiaries; and using payment mechanisms that move benefits from the treasury to the individual recipient with as few intermediaries as possible, to reduce the potential for diversion of funds.

2. **Setting up adequate administrative procedures** (see Table 2). These include: ensuring that administrative processes are clearly defined and that staff and other resources are adequate to carry them out; instituting a range of quality control procedures to ensure that eligibility criteria are respected, payments are audited, information systems have appropriate safeguards, etc; establishing sensible tolerances in the quality control procedures to facilitate respect for rules and make efforts to enforce them more cost-effective; setting up adequate grievance, appeal and “whistle-blowing” procedures for applicants who believe they are eligible but were denied entry, for beneficiaries who are receiving incorrect payments or are requested to pay kickbacks, for program workers who suspect fraud by other program workers, for the general public who suspect irregularities of any

**Table 2. Administrative Procedures to Minimize EFC**

Outcome	Actions taken
<b>Prevention</b>	<ul style="list-style-type: none"> <li>• Tighter checks at outset of claim.</li> <li>• Make payments directly to bank accounts instead of by check.</li> <li>• Staff training.</li> <li>• Fraud-proof the new policy and operational developments.</li> </ul>
<b>Detection</b>	<ul style="list-style-type: none"> <li>• Data matching.</li> <li>• Investigation: random or time-based reviews (controls of the accuracy of the information provided to the program and of the decisions made by staff);</li> <li>• Intelligence: gathering information from the public (tip-offs); telephone hotline for reporting fraud; automatic flags from Management Information System (MIS).</li> <li>• Risk profiling: risk-based assessments to organise reviews (e.g. select client investigations) using scoring; profiling;</li> <li>• Joint operations with other agencies.</li> </ul>
<b>Deterrence</b>	<ul style="list-style-type: none"> <li>• Sanctions.</li> <li>• Prosecutions.</li> <li>• Confiscation of assets.</li> <li>• Measures to influence public attitudes, such as public awareness campaigns.</li> </ul>
<b>Monitoring</b>	<ul style="list-style-type: none"> <li>• Measure regularly the level of EFC, to assess whether the strategy works.</li> </ul>

sort; and taking action against miscreants with meaningful penalties. Box 2 presents some innovative instruments used in OECD countries to reduce the incidence of EFC.

3. **Aligning institutional responsibilities well.** The delivery involves actions by and interactions among different entities. The system of incentives must be aligned with roles to facilitate the role of and rely on third parties (local government, health and school officials) and civil society organizations. A clear definition of responsibilities is necessary.

4. **Using transparency and communication well** to ensure that eligibility criteria, benefit levels, and rules are clear to both the public and beneficiaries. This reduces EFC as well as unwarranted appeals or complaints.

To assure successful delivery of social protection benefits to the intended beneficiaries, specific recommendations to minimize the risk of EFC must be considered at each critical stage of program design and implementation (Table 3).

### **Box 2. Innovative approaches in the fight against EFC in OECD Countries**

Developed countries' experience shows that reducing EFC is feasible and cost-effective. For example, the US Food Stamps Program reduced its overpayment rate from 10% a decade ago to about 4%. From 1997 to 2006, the UK halved the level of fraud in the social protection sector. To obtain these results, programs invested in developing appropriate procedures, staff and IT support.

NAO (2006) summarizes a number of innovative approaches used in SP programs in 9 OECD countries. It is by no means a comprehensive list of what countries are doing in the field of anti-fraud and error. The anti-fraud and error activities identified are organized in three categories: prevention, detection, and deterrence. These categories overlap and some activities or initiatives will cover more than one thematic category:

- In prevention, Canada holds claimant information sessions (CIS) with groups at high risk of committing benefit fraud. Since 1999, Canada claims it has saved about US\$600 million in overpayments in the benefit system. The Netherlands also uses contracts and campaigns to inform claimants of their rights as a preventative measure. Claimants sign a contract that explains rights and obligations when claiming benefits. Similarly, the New Zealand government aims to inform about 70% of claimants of rights and obligations. These measures aim to inform and remind claimants of their obligations. The underlying idea being that a better informed clientele is less likely to commit fraud. For error, preventative measures include staff training and introducing results-based management. In Canada, error rates have fallen by making line managers more accountable for the errors of their staff. Ireland aims to half its error rate through staff training.
- In the detection category, data-matching is used in all countries. Data-matching can be highly cost-effective and target ratios are set in Australia and New Zealand for overpayments identified to cost of the program. A normal ratio would be four to one. So, data-matching can be highly cost-effective. Unique identifiers for claimants are also often part of data-matching strategies. The use of identifiers across different databases and departments allows analysts to more effectively match data on claimants held in different databases. Review activities are also instrumental to detection efforts. Different strategies are used in most countries ranging from risk-based reviews (e.g. reviews of certain professions in Canada, scoring in the UK, and profiling in Canada) to random and time-based reviews. In New Zealand, claimants have to re-establish core eligibility after a certain time period.
- In deterrence, the main levers reported are increased sanctions and increases in the rates of prosecutions. This is done in Ireland, the US, and the UK.

*Source: based on NAO (2006)*

**Table 3. Use EFC Lenses on Critical Phases of the Program**

Phase	Recommendation
<i>Institutional Design</i>	Define lines of authority and accountability, including administration and service delivery. Align incentives and financing, particularly for intergovernmental responsibilities. Identify risks and remedies up front.
<i>Eligibility, Recertification</i>	Minimize inclusion and exclusion errors.
<i>Conditionality</i>	Balance accuracy and the burden of verification. Examine reasons for non-compliance.
<i>Payment processes</i>	Improve monitoring of cash flows and control procedures.
<i>Management Information Systems (MIS)</i>	Strengthen framework to analyze and design MIS systems. Promote the crosschecking of enrollments with other databases.
<i>Internal quality control</i>	Expand process evaluation, feed-back loops, and correction mechanisms within programs, particularly through spot checks.
<i>Appeals and complaints</i>	Handle complaints and appeals appropriately and in a timely manner, and publish program data.
<i>Financial management and auditing</i>	Define payment accounting and reporting requirements. Focus audits on risks. Include supreme audit institutions.
<i>Procurement</i>	Closely supervise implementation of large service contracts.

Adapted from: World Bank (2007)

Even though developing countries seem to “underutilize” some of the instruments used OECD countries to control errors and fraud, some positive trends are emerging, such as greater use of technology, at least in MICs; more explicit thought on transparency; and greater attention to implementation issues (see Box 3 for examples). Better practices in collecting and using program information in developing countries can provide an indication of the scope and nature of the problem, and may even prevent EFC from happening. A number of MICs are making large investment in MISs of the SP program, a key tool for the development of an effective policy to combat EFC.

**There are a number of lessons to be learned from the experience of developed countries:**

- (1) Although it is virtually impossible to operate an error-free system, it is important to place the reduction of EFC as one of the priorities, and to institute appropriate mechanisms.
- (2) There is ample evidence that some instruments to combat EFC are cost effective and represent a wise investment, although it will add to its administrative cost.
- (3) Most measures to combat EFC require good management of program information, a good MIS.
- (4) The use of multiple instruments strengthens the system.
- (5) Adequate program control and the introduction of incentive-based systems (with appropriate rewards and penalties) are particularly important, especially when implementation is decentralized.
- (6) There is no ready-made solution: each EFC policy should be tailored to the specific program and the characteristics of the country; programs are not isolated within a country, they reflect character of overall government-wide governance agenda.

**Stepping up the effort to combat EFC will likely depend on the level of development of the country, and the institutional maturity of the program.** Such systems take some time to develop and so are more feasible or effective in permanent programs. As MICs are moving away from stop-start safety net programs around economic crisis or transitions of government, more sophisticated experience is developing there. We believe that many MICs are ripe to absorb many of the techniques and innovations used in OECD countries. LICs should probably start by investing in solid MISs.

**Some of the measures against EFC involve trade-offs with other desirable features of safety net policy.** While reducing EFC is important, one should not overdo it at the expense of other program objectives. For example:

- (1) Fully funding the safety nets should eliminate a source of corruption, but it is not always feasible given budget constraints.
- (2) Keeping eligibility criteria and payment structures simple will reduce the probabilities of EFC, but will make programs less precise in their targeting and lower the impact on poverty per dollar spent on legitimate beneficiaries. Thus, policymakers will find themselves foregoing some of the design options for minimizing EFC, and thus will need to develop correspondingly more sophisticated administrative procedures as alternative means of keeping problems in check.
- (3) Avoid EFC activities that deter honest clients. The main purpose of a social program is to transfer resources to its target group. Likely, most of the applicants are honest, and should not be deterred from accessing the program by EFC measures that are too inquisitive, aggressive or insensitive.
- (4) Activities to combat EFC may be at odds with other important objectives of the program, such as client satisfaction (which may require processing claims faster, but that will squeeze the verification efforts, hence the level of EFC).

### Box 3. Good practice of oversight and control mechanisms from the Latin America Region

A number of middle-income countries have made significant steps forward in implementing mechanisms to control the use of funds in SSN programs:

- a) **Brazil's Bolsa Familia Program (BFP)** is a large conditional cash transfer (CCT) program implemented in a federal context. At federal level, the program is managed by the Ministry of Social Development (MDS). Most of its implementation, however, is done by the 5,564 municipalities. Consequently, the main pressure points for EFC in Brazil's decentralized context include political interference, political biases, and administrative errors in the registration process. To manage, monitor and reduce the risk of EFT, the Government has instituted several mechanisms, including: (a) **Oversight & Control by Supreme Audit Agencies** that undertakes regular random-sample operational audits (also known as quality control reviews); implementation evaluations; annual financial audits, and investigation of at-risk cases; (b) **MDS' own program controls**, including internal and external cross-checks of the registry; monitoring municipal implementation quality using the new system of financial incentives (performance-based administrative cost subsidies) and the "Decentralized Management Index", and; monitoring of the activities of the operating agent for registry and payments, via the new performance-based contract and associated financial penalties, and; (c) **Municipal controls (social controls, local contacts)**. Municipalities serve as first point of contact for complaints or appeals for the beneficiaries. Formal Social Controls Councils have been established in all municipalities, and their roles include: overseeing the registration process; periodically evaluating beneficiary list; monitoring reporting on, and compliance with, conditionalities. Centralized **hotlines** are used to handle inquiries from general public, beneficiaries, and local program managers.
- b) **The Heads of Household Program in Argentina** is a large-scale emergency workfare program set up quickly during 2001-2 economic crisis. The Ministry of Labor is the responsible national agency and registration is decentralized through municipalities and civil society/political organizations. A set of complaint resolution tools has been established, including: (a) **Toll free hotlines** manned by call centers addressing questions on payment dates, eligibility and for reporting ineligible beneficiaries; (b) **a Commission in the Ministry of Labor** to handle allegations of program abuse or complaints; (c) Criminal offenses referred to **Federal Prosecutor** of the Social Security System.
- c) **Colombia's Familias en Accion** is a CCT program under Presidential Executive Agency (Social Action) implemented at municipal level. **Spot checks** reviewing and monitoring the operational procedures for program implementation in different localities are carried out on a random basis by external firm every 6 months. These spot checks serve several objectives, such as: checking if operations and procedures of program met objectives in practice; verifying how procedures were being interpreted; validating the accuracy of the data relevant for the program (i.e. verification of fulfillment of conditionalities, inscription of eligible families, payments, etc.).

Source: Lindert et al (2007) and World Bank (2007)

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The World Bank Social Safety Nets Primer series is intended to provide a practical resource for those engaged in the design and implementation of safety net programs around the world. Readers will find information on good practices for a variety of types of interventions, country contexts, themes and target groups, as well as current thinking on the role of social safety nets in the broader development agenda.



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