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Session 3 – Labour Market Policies for Sustainable Employment

Topic: Financing Social and Labour Market Policies in Times of Crisis and Beyond

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1. Introduction

After massive bank bail-outs had dominated early crisis responses, a *Global Jobs Pact* was adopted by the ILO in 2009 to address the neglected social and employment impact of the international financial and economic crisis, promoting a recovery based on investment, employment and social protection. Grounded in the *Decent Work Agenda*, the Pact calls for coordinated global policy action and policy measures at the national level to retain workers in employment, to support small and medium enterprises (SMEs), to foster job creation and productive investment, to act positively on labour supply and demand, to invest in skills and education, to provide social protection to those affected by the crisis and to protect wages (ILO 2009a). The document mentions explicitly the need to support developing countries and Least Developed Countries (LDCs) with limited fiscal space and state capacity through additional donor funding and cooperation. However, the mobilization of revenues in times of crises is not only a challenge for the poorest countries: after initial fiscal stimulus packages have dominated policy responses during the period 2009-10, the world is shifting more and more towards austerity, with potentially adverse consequences for the incipient recovery process, inclusive development and the attainment of the MDGs.[2]

This paper will examine the question of financing labour market and social policies in a context of crisis and beyond. It draws on recent UNRISD research on “Financing Social Policy” and poverty reduction, and promotes an integrated analysis of the economic, social and political dimensions of the development process as envisaged by the Copenhagen Declaration on Social Development.[3] Although issues of financing are usually treated separately from social policy, the latter being primarily concerned with social expenditure and social outcomes, it is our understanding that both have to be approached simultaneously in order to design social and economic systems that are mutually reinforcing and sustainable. Fortunately, social policy including labour market policies is increasingly seen as an investment rather than a cost factor or “unproductive” consumption as happened in the past. However, in the case of the current crisis, social policy and labour markets did not receive sufficient attention as governments tended to prioritize stabilization of the macro-economy, especially of the financial sector, risking a scenario of jobless recovery and erosion of social protection.

The main conclusion of the paper is that countries with broad and institutionalized social and labour market policies are better prepared to respond to a crisis situation and to mobilize

[1] United Nations Research Institute for Social Development, research assistance and very useful comments from Mariana Rulli are gratefully acknowledged.
[2] According to Kyrili and Martin (2010), most LICs have started to cut social expenditures, especially in education and social protection.
[3] ”Hujo and McClanahan 2009; Hujo forthcoming; Hinojosa et al. 2010; UNRISD 2010b, UNRISD 2010a: Chapter 8.

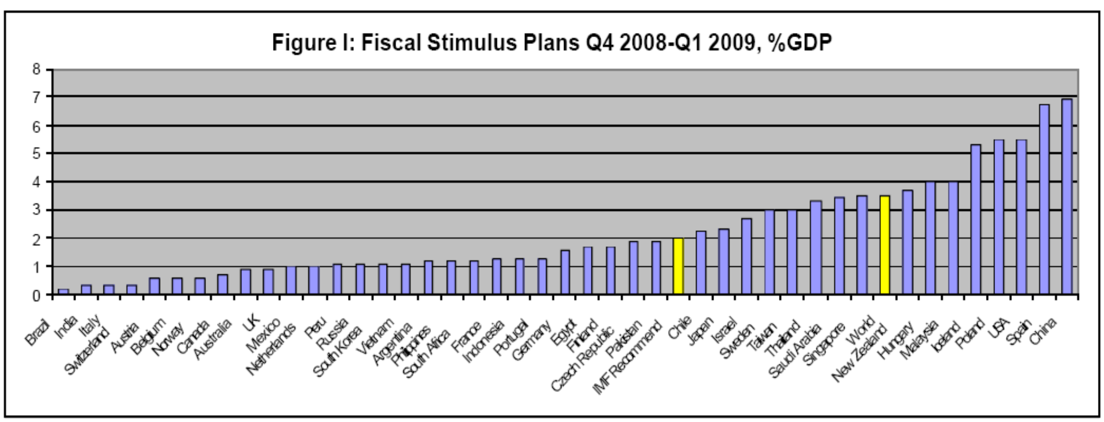
additional funding to support a job-rich recovery process. However, aid, international funds and stabilization mechanisms at regional and global levels are required for countries with limited fiscal space and high exposure to global market risks – a challenge in a global environment where rich as well as poor countries face similar financing pressures and policy makers seem to be increasingly reluctant to support a global solidarity agenda.

The paper is organized into six parts: the second section introduces the general background, the third section discusses the concept of fiscal space and affordability, the fourth section analyses different revenue sources and their developmental impact, the fifth section gives some country examples on financing labour market policies, and the sixth section concludes.

2. The Context: Social Protection and Labour Markets in Times of Crisis

The effects of the global financial and economic crisis starting in 2008 have been transmitted towards the developing countries through several channels, notably foreign capital and domestic credit, trade and foreign direct investment (FDI), commodity prices and terms of trade as well as remittances. As a consequence, countries across the globe have suffered declines in national income, investment, employment, worsening fiscal accounts and balance of payments, increasing debt and financial sector distress (ILO 2009b; IMF 2009b, World Bank 2009, UNCTAD 2010). At a micro level, the negative impact on well-being has occurred mainly through deterioration of the labour market situation (unemployment, wage declines, and increased informalization), price hikes in financial and goods markets, effects on household income and assets (savings, assets, unpaid work, remittances) and through adverse effects on social protection provided through states, markets and communities (McCord 2010, Mesa-Lago 2009, Hujo and Gaia 2011).
In most countries, at least initially, the public sector has responded with counter-cyclical measures, both in the economic and social sectors, trying to offset some of the negative impacts of the crisis on economic activity and employment and to cushion adverse effects on the population through labour market policies (LMPs), cash transfer programmes, public work schemes, food subsidies and investments in social infrastructure. These measures were partly financed through fiscal stimulus packages, with expenditure on social protection accounting on average for 25 per cent of stimuli (Zhang et al. 2010).

Figure 1: Fiscal Stimulus Plans



Source: Ortiz 2009b.

Apart from the fact that this time they were not at the origin of the crisis, most authors agree that developing countries have been more resilient with regard to this crisis as compared to previous crisis episodes, mainly due to improved fundamentals (debt, financial sector, balance of payments, exchange rates and monetary indicators, foreign reserves) which are largely the result of the strong growth period over the middle of the 2000s and some policy changes at the global and national level such as the debt relief granted through the HIPC initiative, a reduction of public debt in selected middle income countries, and a turn towards heterodox economic policies and expansion of social policies in selected countries.[4] However, the fact that many countries displayed greater room for countercyclical policy responses and less exposure to the financial fall-out of the crisis does not mean that the crisis has been without costs nor that countries have fully recovered towards pre-crisis levels.
In its third year, the following crisis effects are still visible:

- A downturn in levels of global economic activity, with persistently lower demand from the US and the Euro zone;
- A sequencing from initial fiscal stimulus to fiscal consolidation/austerity with potentially adverse impacts for necessary long term investments in economic and social policy:
- Deterioration of basic economic indicators of the public and private sector (fiscal deficits, balance of payments, inflation, debt, etc.);
- A deterioration in employment and labour market indicators, with higher levels of unemployment and non-standard or more precarious forms of employment (temporary, part-time, self-employment, informal employment) with long term effects on human capital and productivity;
- Exhaustion of self-insurance mechanism at the micro and macro level (foreign reserves, household savings and assets, unpaid work, remittances, community assets);
- Uncertainties with regard to future viability of export-led growth models, especially those based on commodities and certain types of manufactured goods;
- Uncertainties with regard to achievability of the global poverty agenda and the prospects for a more stable and just international financial architecture.

It is hence imperative to continue efforts at reactivating the global economy through appropriate economic and social policies. The following section will focus on the issue of fiscal space and affordability of public policies, before we present some evidence on how countries have mobilized and allocated funds and what are the challenges for the future.

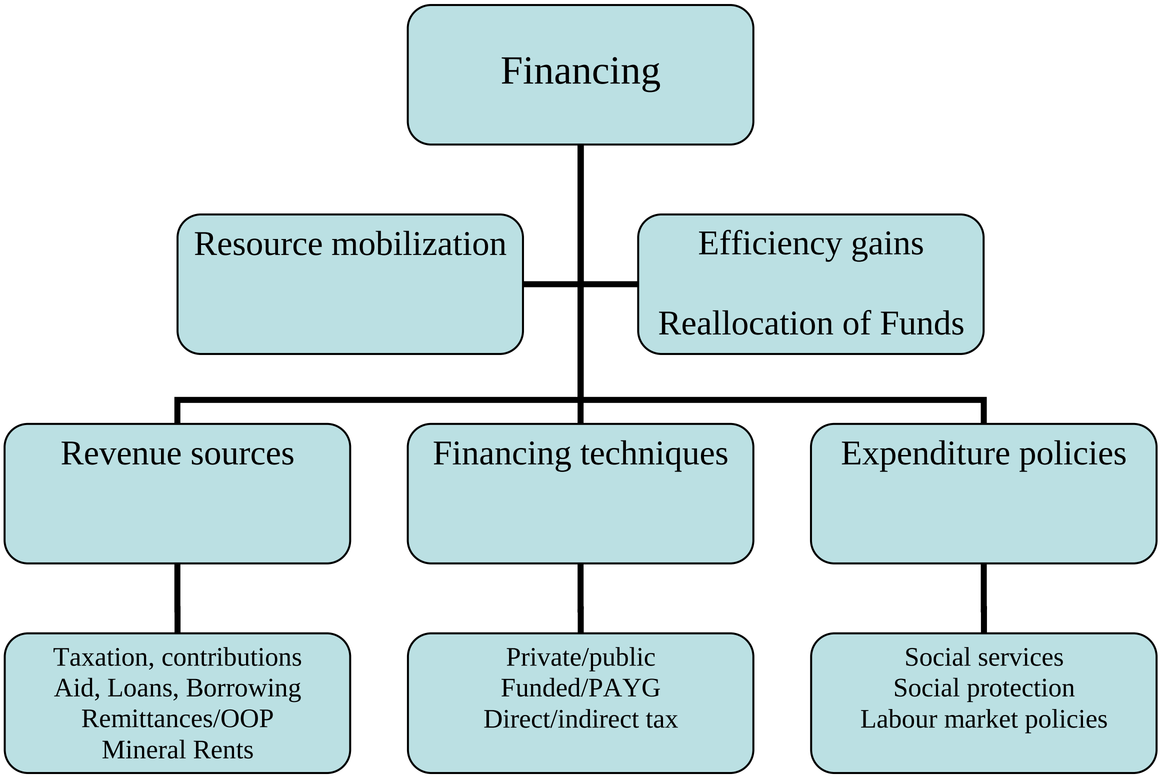
3. Financing Social and Labour Market Policies: Fiscal Space and Affordability

Fiscal Space
The availability of budgetary room to finance public policies in a sustainable way is labelled *fiscal space* (Heller 2005). Fiscal sustainability implies that governments are able to finance

[4] See for example Ocampo 2009, UNCTAD 2010, Ferreira and Shady 2009.

planned expenditures while honouring any debt obligations and ensuring solvency in the medium to long term.[5]

Figure 2: Financing Social Policy



Source: Own elaboration.

In general, fiscal space depends on a country's economic performance, including its capacity to produce income and savings and to generate government revenues; the performance of its domestic capital and financial markets; and the availability of external funding such as foreign investment, loans or grants. A dynamic economic environment and a stable world economy are therefore key determinants of healthy national public finances.[6]

The global crisis has affected fiscal space negatively. Fiscal deficits rose sharply due to falling revenues in combination with expenditure increases, as figure 3 illustrates.

In order to create additional fiscal space for social policies (or MDG related policies or development enhancing policies more generally), two basic options stand out:

i. Reallocation of existing revenues
ii. Mobilization of additional revenues

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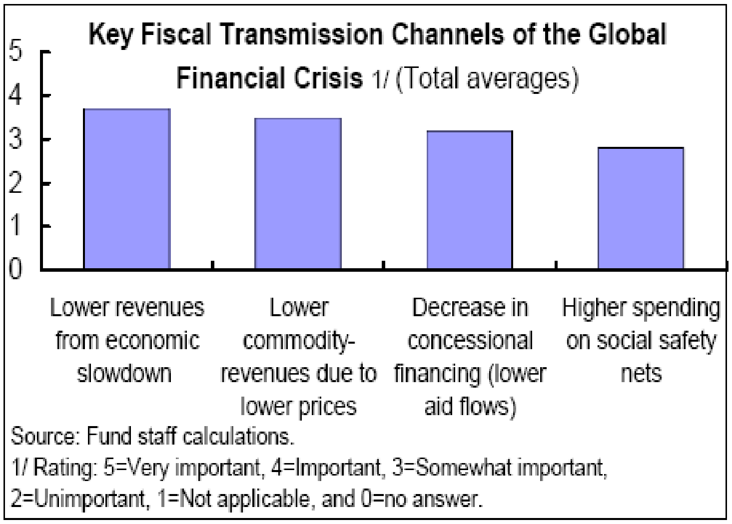
[5] The literature on debt sustainability is vast, at a minimum, variables such as a country's growth rate, exports, remittances, interest rates, revenue elasticities, composition of existing debt in terms of interest rates, maturity, currency denomination has to be taken into account, see Heller 2005.

[6] Mobilizing resources is, however, only part of the battle. Decisions about revenue policies and the allocation of public funds are the result of political processes, often dominated by elite groups. Consequently, such policies may not lead to the best outcomes in terms of providing public goods and reducing poverty. Furthermore, institutional capacity, including the quality and efficiency of public administration and service providers, influences how successfully resources are translated into social outcomes, see UNRISD 2010b.

Figure 3: Fiscal Transmission Channels



Source: IMF 2009b:21.

Reallocation or reprioritization of expenditure is usually the first option to look into for governments aiming at a greater economic and social efficiency of public expenditures, especially in times where key economic, social or political variables change, for example in the case of economic or political crisis or natural disasters, or changing demographics. The room for reprioritization is, however, limited in most countries, as a significant part of the budget is tied up in so-called non-discretionary spending (spending mandated by law, for example social security spending, in contrast to discretionary spending that is decided annually by government and parliament). Reductions in public sector employment, wages or subsidies may entail significant political costs and are likely to be counterproductive with regard to employment goals and demand stabilization. In the case of aid-dependent countries, conditionalities on how to spend funds limit the space for discretionary government spending. In addition, the following aspects have to be considered carefully in order to avoid that immediate savings are offset by higher future costs:

- Cutting back programmes in times of crisis can be costly over time, if expensive rebuilding of institutions and programmes afterwards is deemed necessary;
- Efficiency gains through improved implementation of programmes (including programmes financed through aid which can be costly due to donor coordination and conditionalities) are a long term endeavour and can usually not be achieved in the short term or in a crisis situation;
- Any reform has to take into account potential future liabilities and contingent costs as well as shifts in the maturity and sequencing of financial liabilities, which can have adverse effects on the short term fiscal position of countries, triggering adverse market reactions.[7]

[7] Privatization of public pay-as-you-go pension schemes illustrates the argument: long-term liabilities, the so-called implicit pension debt, is made explicit with immediate consequences for public debt and fiscal deficits (workers save their contributions on individual accounts and the state has to finance current pension expenditures through the general budget), see Arenas de Mesa and Mesa-Lago 2006 for Chile and Hujo 2004 for the Argentinian case and the link between pension reform and the break-down of the currency board in 2001.

With regard to *mobilizing additional revenues* the instruments used fall into the following categories:

Table 1: Mobilizing Revenues – timing and conditions

Instrument	Short term potential	Medium to long term potential	Supporting conditions
Tax reform	Low	high	-Political support -Growth -State capacity -Growth of formal economy
Extension of contributory systems	Low	high	-Employment-intensive growth -Growth of formal economy -Organized labour force -State capacity -Insurance markets
Capture of mineral rents	Low	high	-State capacity (Negotiation with foreign investors/management Dutch disease) -Rising commodity prices -Improved sector productivity -Strong public enterprise
Foreign aid	High	high	-Predictable and sustainable donor commitments -Global growth -Innovative Funds and Instruments -Management of Dutch disease effects
Domestic and external borrowing	High	high	-Economic stability -Interest rates and country risk -Access to international credit markets -Developed national capital markets/financial sector -Debt sustainability/repayment capacity
Public private partnerships	Medium	High	-Higher private sector efficiency -Low risk of private sector insolvency

Source: Own elaboration.

In a context of crisis, the potential for implementing structural reforms such as tax reforms, expansion of contributory systems or capture of a greater share of commodity production seems limited, at least in the very short term: governments typically implement tax and contribution reductions and exemptions in a crisis with the objective to stabilize production and employment levels, whereas commodity sectors such as oil and minerals tend to suffer from price declines in global markets.[8] Additional public borrowing, use of foreign reserves or sovereign funds, and foreign aid are the dominant instruments in a recession, although conditions with regard to access to credit and credit costs often deteriorate as well.

Lastly, an important question is how to actually *estimate or calculate fiscal space and fiscal affordability* (taking into account both expenditures and revenues) for social policies including labour market policies in a particular country or country group. For this exercise, one approach is

[8] There is however, some evidence that reforms that are already under debate or part of a broader strategy can be accelerated by a crisis (the so-called benefit of crisis hypothesis), this happened for example with market-oriented reforms during the 1990s in Latin America or Eastern Europe and expansion of social protection in Asia after the 1997 crisis.

to compare national revenue and expenditure figures with international benchmarks, for example how a country compares in terms of tax revenues or social expenditure (both level and composition) as a percentage of GDP with average performance of countries within the same income group or region (see table 2 and figure 5). If a country is significantly below the average, this is interpreted as an indication that there is room to increase tax efforts or to spend more on social policies.

We can, for example, observe that although public social expenditure as a share of GDP rises with income, with high-income countries in the North spending the most, countries with a comparable income level display significantly different levels of expenditure on social protection and social services (table 2).[9]

Table 2: Government expenditure on social protection, social insurance and social assistance (% of GDP)

Country	Year	Social protection	Social insurance	Social assistance
Argentina	2004	9.2	7.7	1.5
Brazil	2004	13.2	11.7	1.4
Mexico	2002	3.5	2.6	1.0
Guatemala	2000	1.8	0.7	1.1
Viet Nam	early 2000s	3.5	1.9	0.5
Mongolia	early 2000s	10.5	7.8	1.1
Indonesia	early 2000s	1.9	1.3	0.3

Note: Social protection expenditure includes public expenditure on social insurance and social assistance, as well as other programmes, such as housing, municipal and community services.
Source: Barrientos 2010.

These differences can be taken as an indicator that there is no fixed relationship between income level and public social expenditure and that affordability is to a large extent a question of political priorities and institutional legacies such as the prevailing welfare regime in the country (UNRISD 2010b).

A second approach is to compare actual spending on social protection with estimated costs of a basic social protection package (ILO 2008) in order to determine whether additional social expenditures could be deemed affordable or whether the actual spending commitments match the costs of such a package (Bauer et al. 2010, ESCAP 2011); similar costing models have been developed to assess necessary spending to attain the MDGs (Vos et al. 2008) or for calculating the costs of specific programmes such as social pensions or other cash transfers.[10]

Thirdly, more detailed calculations of fiscal space or fiscal affordability of planned reforms take place at the country level, for example as part of IMF or World Bank supported programmes, taking into account the mentioned issues of debt sustainability, medium-term fiscal strategies and macroeconomic stability. Kyrili and Martin (2010) have developed a fiscal space index for IDA countries in order to calculate how these countries could respond to decreased revenues in the current crisis context.[11] They assess the potential to borrow (domestically and externally), to mobilize additional domestic revenues such as taxation, and to mobilize more grants, taking into account additional indicators such as fiscal deficits and inflation. They find that more than half of

[9] De Haan 2007; Besley et al. 2003.
[10] Organizations like HelpAge international and UNICEF have developed costing tools, see www.helpage.org and www.unicef.org.
[11] Their fiscal space index, first developed for UNESCO (Martin and Kyrili 2009), draws on the fiscal space diamond developed by IMF and World Bank and UNDP (Development Committee 2006, Rathin et al. 2007).

the countries in the sample (54 LICs) have no space to increase domestic revenue and more than half of the countries have already critical levels of debt, leading to their conclusion that scaling up of aid for the majority of countries which are not aid dependent is the preferred option.

Our brief discussion on how to measure fiscal space and affordability is not meant to be comprehensive. The following two issues invite for further thinking:

- Firstly, fiscal space is a concept that has to be embedded in a specific country context, paying due attention to its economic, social and political structure, integration pattern into world markets and the medium to long term nature of structural reforms and processes of social change;
- Secondly, costing models and debates on sustainable financing have problems in measuring economic and social costs and benefits that are not easily expressed in monetary terms or not easily estimated due to the complexity of variables involved: what are the opportunity costs of not investing in decent work and social policies? How to measure indirect social costs of targeting or increased risk associated with market insurance? What are the distributional and developmental effects of tax reform and public borrowing? What are the systemic costs for the global community of not delivering on aid commitments?

Finding answers to these questions requires moving beyond a crisis context and to explore the issue of how to build sustainable and equitable financing systems for social protection and social development in normal times, to analyse the political economy of reform processes and budget allocations and to combine different methodologies for measuring fiscal space and the long term costs and benefits of social policy.

4. Thinking beyond a crisis context: social policies need sustainable and equitable financing[12]

4.1 Distributional and developmental impact of revenue instruments

In the same way as the impact of different social policy or labour market instruments with regard to objectives and outcomes are assessed, decisions have to be taken on how to design and develop sustainable and equitable funding schemes. Which revenue instruments are best suited to generate sufficient funding while minimizing or avoiding negative consequences for production, redistribution and equity? Financing instruments can be classified according to whether they are *distributionally* progressive (redistributing from rich to poor), neutral or regressive, or based on normative principles of individualism or solidarity (see figure 4). From a point of view of distributional justice, at any level of resources, financing instruments become preferable as their progressiveness increases (in terms of redistributing resources towards lower income, disadvantaged or vulnerable groups, including women, ethnic minorities, rural dwellers, children, the elderly and the chronically ill).

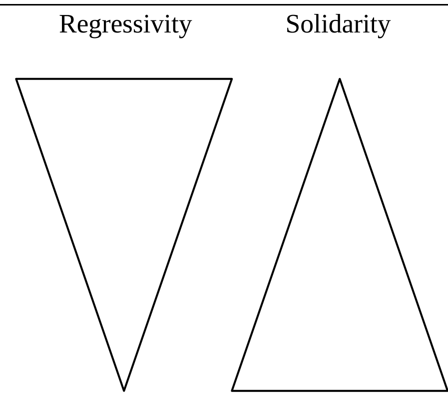
From a macroeconomic perspective the stabilization and growth effects of different revenue instruments are of interest. Progressive tax systems combined with transfer schemes are also known as automatic stabilizers, smoothing both boom and bust cycles. They are a means to *combine redistribution with macroeconomic stabilization*. In addition, social insurance programmes financed through contributions can support economic development in a variety of

[12] This section draws heavily on chapter 8 in UNRISD 2010b.

ways. For example, funded social protection schemes such as pension funds can be a source of finance, stimulating financial sector development and, in the case of occupational funds, providing "patient capital" (long-term financing) and wage moderation to firms, while supporting employment stability and incentives for workers to invest in industry-specific and/or firm-specific skills.[13] Decentralized private pension funds have, on the other hand, proven to be less redistributive and more risky than PAYG schemes while creating a considerable fiscal deficit in the short to medium term if a former public scheme has to be phased out and active contributors start to save into their individual accounts and are no longer financing current pensioners.

Figure 4: Revenue type, distribution and social relations

Time-burden tax (self-provision)
User fees (most regressive, least solidaristic)
Private insurance schemes (pre-paid schemes)
Public insurance schemes
Indirect taxes
Earmarked taxes
Direct taxes (most progressive, most solidaristic)



Source: Based on Delamonica and Mehrotra 2009.

An additional concern is whether domestic resources have a different impact on economic development when compared to external resources. Export earnings or private and official transfers and loans (in the form of official development assistance/ODA, and remittances) are denominated in foreign currency and have a potentially negative effect on macroeconomic stability. In addition, aid—grants and low-interest loans—is subject to conditionality, while loans might adversely affect debt sustainability.

4.2 Public revenues - options and constraints

Creating fair and efficient tax systems

In developing countries, designing equitable and efficient tax systems is crucial to financing social policy in a context of consistent national development strategies and strong state-citizen relationships. The mobilization of domestic resources through tax reform was considered a pillar of the 2002 Monterrey Consensus on Financing for Development and its follow-up declaration in Doha in 2008.[14] It is also recommended as the principal financing strategy (together with limited public and foreign borrowing, reallocation of funds and efficiency-enhancing measures) for Latin America and the Caribbean for achieving the MDGs.[15] Taxation revenue is generally deemed superior to other sources because of its stability and its potential for distributional justice and for financing programmes with universal coverage. Tax systems are also said to enhance state ownership and accountability as compared to external revenues, which in the case of aid, for

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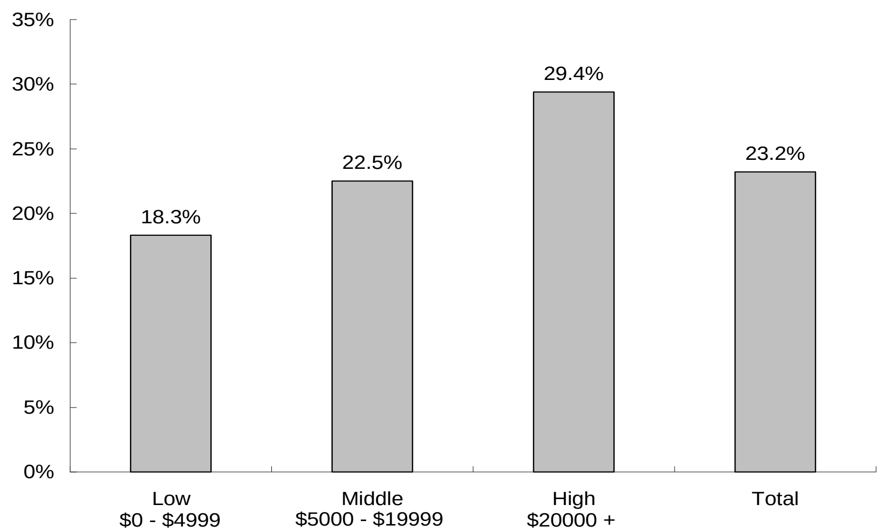
13 Manow 2001; Estevez-Abe et al. 1999.
14 United Nations 2008.
15 Vos et al. 2008.

example, is tied to donor conditionality, therefore bypassing national constituencies and political institutions.[16]

While tax shares tend to grow as GDP does (see figure 5), important variations can be found within each income group.[17] The Netherlands and Sweden collect over 45 per cent of GDP in taxes. In Japan and the United States, the share is less than 40 per cent; in Brazil and South Africa, it is over 35 per cent; and in Colombia and Mexico, less than 15 per cent (all include social insurance contributions, on data sources see UNRISD 2010b). How can these differences be explained?

Figure 5: Tax revenue as a percentage of GDP in low-, middle- and high-income countries



Source: Bird and Zolt 2005.

Tax capacity in developing countries is determined by the level of development, economic structure (size of the informal sector, size of wage employment, share of agriculture or primary products, reliance on trade), institutional legacies, and political-institutional factors such as state capacity, credibility and what could be labelled tax effort. In many countries, trade liberalization policies have led to the shrinking of total tax revenues, despite the fact that efforts were made to make up for losses through new and supposedly less distortionary taxes, such as consumption taxes. Several studies[18] show mixed results for the recovery of lost trade revenues, but the positive trends largely reflect gains in middle-income countries from the implementation of VAT.[19] In contrast, low-income countries, by and large, have not enjoyed revenue gains from such taxes due to problems with refund and credit mechanisms, underpayment and high levels of informality.[20]

Recent tax reforms have not only led to shrinking tax revenues; they have also switched the overall tax structure towards more regressive consumption taxes. Meanwhile, in Latin America, personal income and property taxes, and taxes on corporate income, profits and capital gains have, on average, fallen. Tax revenues have also been negatively affected by economic crises, de-

[16] Moore 2004; Fjeldstad and Rakner 2003; Bräutigam et al. 2008.
[17] Di John 2008.
[18] Gupta et al. 2005; Glenday 2006; Aizenman and Jinjarak 2006, cited in Sindzingre 2009.
[19] See Jiménez and Goméz Sabaini 2009 for Latin America.
[20] Sindzingre 2009; Di John 2008.

industrialization and growing informalization—particularly in Latin America, sub-Saharan Africa and transition economies (UNRISD 2010b).

Tax reform including more efficient tax administration and measures against evasion remain key policy issues for most countries. The well-known challenges are to obtain higher tax receipts from high income groups, property and asset owners, financial transactions, mineral rents and large commodity producers and environmentally damaging production. Di John (2008) recommends exploring alternative approaches for LICs such as tariffs on commodity exports, land and property taxes, urban property taxes and agricultural marketing boards. At the global level, discussions continue on the potential and practicability of international taxes, global funds and reforms of the international financial architecture (UNDESA 2011).

Contributory social insurance systems

Social insurance schemes are a common instrument to finance and provide social transfers. They can be initiated on a small scale and gradually extended to other groups of citizens as the formal economy expands. Nevertheless, the fact that demographic change and, more recently, labour market flexibilization and informality are resulting in shrinking numbers of active contributors and growing numbers of beneficiaries raises a key question: how can extending social insurance programmes become a viable financial option for developing countries?

In most countries, the supposed attraction of contribution-financed schemes—their fiscal neutrality—no longer holds true. Increasing subsidies to make up for deficits, unless explicitly used to incorporate low-income groups, not only creates a fiscal problem, but is also questionable in terms of equity: most low-income earners in developing countries are excluded from formal social insurance programmes. If these programmes benefit from subsidies financed via general revenues, regressive redistribution might take place, especially if subsidies benefit special programmes such as civil servants' pension, and the tax system relies heavily on consumption taxes (UNRISD 2010b).

Whereas contributory social insurance programmes can be set up for a variety of contingencies, such as sickness, disability and death of the main breadwinner, old age, work accidents and unemployment, coverage rates are largely insufficient in most developing countries (ILO 2010a, Barrientos 2010) and provisions for the unemployed are still the exception (see section 5). As with tax systems, the specific design of social insurance programmes matters, both in terms of financial stability, redistribution, equity, social cohesion and contribution to economic growth. With regard to extension of contributory insurance schemes in contexts where informality and poverty affect a considerable part of the population, innovative approaches, financial incentives and commitment of the state have contributed positively in the more successful cases.[21]

Mineral Rents

For many developing countries, natural resource rents represent a substantial and growing proportion of total government revenues, either by means of taxation or royalty payments or direct ownership, with potentially enormous implications for the design and delivery of social policies. Before commodity prices dropped in the context of the recent global economic crisis, these countries experienced a mineral bonanza, which could potentially produce a big push for the development process. Yet there is considerable evidence that many resource-abundant countries have not been able to utilize their resources to induce a process of sustained economic growth, let alone social development involving equitable distribution of the fruits of this natural wealth and overall improvements in the welfare of their citizens.

[21] See UNRISD 2010, Chapter 5, as well as ILO 2010a for best practices in extension of social insurance in different country contexts.

Mineral-rich countries are often said to suffer from a "resource curse", a supposed correlation between natural resource abundance on the one hand, and a set of negative economic, political and social outcomes on the other.[22] However, numerous resource-rich countries do not suffer from these symptoms, which points to the more interesting issue of explaining these variations in outcomes. The main task for research should therefore be to identify intervening variables, such as economic and social policies, or political institutions, that mediate the relationship between mineral-led development paths and developmental outcomes.

One precondition for successfully tapping mineral wealth for social development is to avoid falling into the trap of "Dutch disease". This requires macroeconomic policies that counteract inflationary pressures arising from the huge inflow of foreign exchange stemming from the mineral sector, with negative effects on stability and the competitiveness of manufacturing. Equally important are investments in infrastructure, such as electricity and transport, and in technologies that reduce the adverse environmental effects of mining. Lastly, improved taxation systems and contracts with private investors are crucial to ensure a fair share of income for the state.[23]Resource-rich countries such as Botswana, Chile, Indonesia, Malaysia and Norway have managed the challenge of Dutch disease reasonably well, applying different policy instruments. These include monetary sterilization, reserve accumulation, repayment of foreign debt, purchase of imports, forced savings through budget surpluses or creation of stabilization or pension funds, capital controls to reduce speculative short-term inflows, and social pacts to enforce wage restraint.[24]
In the context of the current crisis, mineral-rich countries have been most severely affected through plummeting commodity prices, which underlines the need to diversify these economies and to improve their capacity for countercyclical macro-policies.

Aid
When identifying possible financing sources for development, taxation and aid are often juxtaposed against each other due to their different effects on economic and political systems. Yet external funding through international development cooperation remains an important pillar of development finance. International donors have agreed to substantially increase ODA for low-income countries in order to accelerate the MDG process. And, although development assistance in the past has shown a procyclical pattern with regard to global economic boom and bust cycles, donors have promised to maintain ODA levels despite the recent economic crisis.[25]

Additional funding for poor countries can ease financial constraints. But, like rents from natural resources, aid flows are volatile, tend to parallel global and national economic trends, and pose a variety of political and economic challenges. These challenges are related to conditionality, accountability and the effects of Dutch disease, which have to be addressed successfully in order to make aid more effective for development.

[22] Sachs and Warner 1995; Auty 2001; Collier and Hoeffler 2005.
[23] Stürmer 2008, see also the studies of UNCTAD (2010) on rent capture with regard to different minerals.
[24] However, some of these countries have not been as successful in terms of fostering democratic governance and equitable social policies. Chile, Indonesia and Malaysia have undermined democratic rights and civil society during long-term dictatorships or electoral democracies with one-party rule and with social policies whose main purpose was to legitimize authoritarian rule.
[25] According to UNDESA 2011, total net ODA of DAC-OECD members has slightly increased by 0.7 per cent in real terms in 2009, to US$ 120 billion, although falling short of donor commitments made at the 2005 G-20 summit in Gleneagles.

Aid can contribute to poverty reduction and have a positive impact on social sector spending, and besides influencing government social spending, aid also affects measures of aggregate welfare—either directly, by creating income-earning opportunities and providing services, or indirectly, by contributing to growth.[26]

Finally, aid is important not only in terms of financing social expenditure (and pro-poor economic infrastructure) in recipient countries, but also as an element of international justice and, as the case of the recent crisis demonstrates, of global stability. Enormous global wealth disparities—half the world's population have access to just 1 per cent of the world's assets—give rise to debates about international redistribution (Ortiz 2009a). Perhaps the most striking aspect of the current global economy is the net transfer of financial resources from poor countries to rich countries, a pattern that persists (UNDESA 2011). Overall, debt interest payments, investment profit remittances, and the portfolio of central bank reserves offset net financial inflows to developing countries. Rich countries, most notably the United States, are at the receiving end of the vast majority of global savings, which has been identified as one of the main causal factors of the global economic crisis.

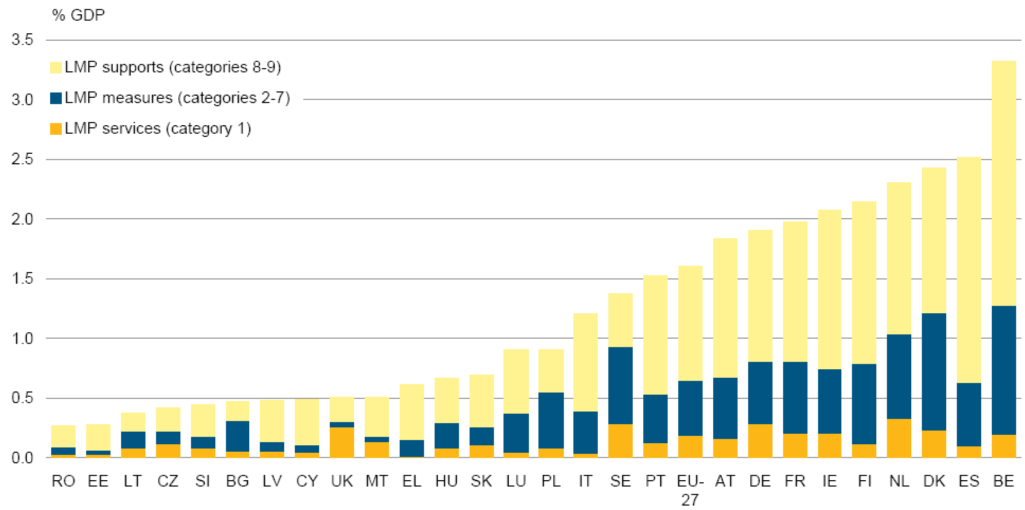
5. Financing of Labour Market Policies: Country Examples

In this section, we will briefly present the example of the European countries before analysing in greater detail policies implemented in selected developing countries with a focus on Latin America.
In 2008, in the European countries (EU-27), unemployment accounted for 5 per cent of total social protection benefits (which sum up to 25.3 per cent of GDP) or 1.3 per cent of GDP (as compared to 37.5 per cent for old age and 28.5 per cent for sickness). The highest levels of unemployment benefits as a share of GDP were recorded in Belgium and Spain with 3.3 and 3.0 per cent of GDP respectively (Puglia 2011). Social protection in Europe (EU-27) is mainly funded through social contributions (57.5 per cent of all receipts) followed by general tax revenues (38.2 per cent, see Puglia 2011).

It is worth noting that the base level of expenditures on labour market policies in Europe is governed by economic, political and historical factors rather than being determined by actual unemployment rates, whereas changes in these expenditures correlate with changes in the level of unemployment: In the three-year period before the crisis (2005-2008), labour market policy expenditure fell by more than 14 per cent in real terms, largely reflecting a 19 per cent decline in the number of unemployed in the same period. During that period, around 60 per cent of total LMP expenditure were spent on unemployment benefits (UB) and early retirement, 12 per cent on labour market services (e.g. public agencies supporting job search) and 28 per cent on active LMP such as training, start-up incentives, job sharing etc. (Gagel 2010).

[26] Morrissey 2009.

Figure 6: LMP Expenditure as Share of GDP, 2008



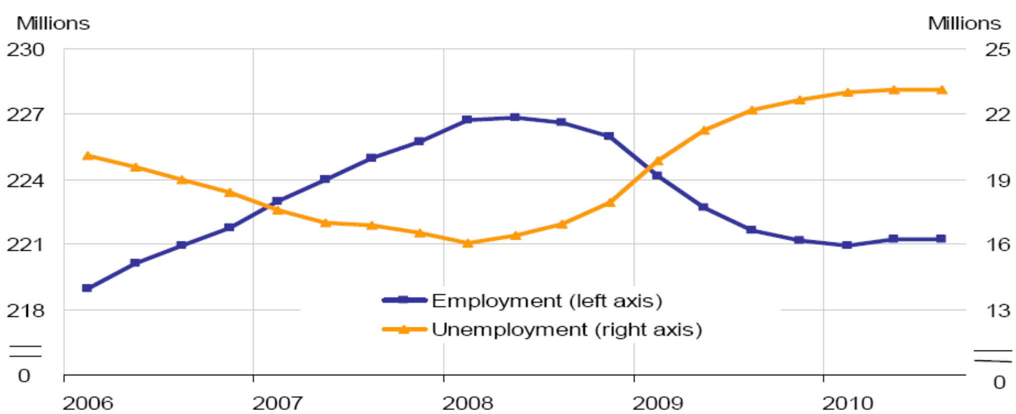
Source: Eurostat (online data code: lmp_expsumm)

Source: Gagel 2010.

The latest figures on LMP expenditures in Europe reflecting the impact of the crisis are not yet published, but a significant increase in expenditures can be expected as a result of increased unemployment and reduced employment (see figure 7): unemployment between 2008 and 2010 increased by 50 per cent to 8.5 per cent (OECD 2011). It goes without saying that large parts of fiscal stimulus packages in Europe and the OECD, especially tax cuts and subsidies for strategic industries, also pursue employment objectives without being reflected in these figures.

Figure 7: Employment and unemployment in the EU

Figure 1: Employment and unemployment, EU-27, seasonally adjusted (million persons)



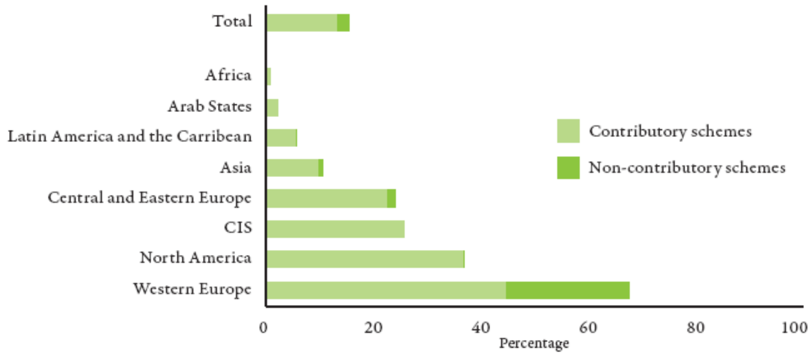
Sources: Eurostat-NA (online data code: namq_aux_pem) and EU-LFS (online data code: une_nb_q)

[1] This publication is part of a quarterly series presenting the main results of the EU labour force survey for the EU-27 and for all Member States, candidate countries and EFTA countries, except Liechtenstein.
[2] National accounts, domestic concept. See also http://epp.eurostat.ec.europa.eu/portal/page/portal/national_accounts/methodology/employment
[3] See the LFS resident population concept in the Methodological Notes.

Source: Massarelli et al. 2011.

As mentioned above, labour market policies and cash benefits for the unemployed is the component within social protection that tends to be least developed in developing countries (figure 8).

Figure 8: Effective coverage as share of unemployed receiving unemployment benefits (regional estimates, latest available year)



Note: Regional estimates weighted by the economically active population.
Sources: ILO Social Security Inquiry database, compiled from data on unemployed receiving unemployment benefits collected from national social security unemployment schemes; ILO, LABORSTA for total unemployed used as the denominator.

Source: ILO 2010a, Figure 5.5

Table 3: Labour market policies and potential funding sources

Policy tool	Financing Source	Challenges/Bottlenecks
Subsidized reduction in working hours (work sharing)	-unemployment insurance/funds -subsidies paid to employers (general revenues)	-can be costly for developing countries
Non-subsidized reduction in working hours	-employees might depend on safety net	-only applicable to formal sector -wages in developing countries on average too low to cut
On-the-job training	-government revenue -enterprises	-low capacity for training
Wage subsidies, cuts to employer social contributions	-government revenue -reserves of social security funds	-high costs, leakage, only for formal sector, problematic for social insurance funds
Public works, CCTs, social assistance	-government revenue -ODA	-widely used, but mixed success due to poor design and implementation -absence of social protection scheme, costly to establish
Job search assistance	-government revenue	-absence of institutions or skilled staff
Training programmes Work experience, apprenticeship programmes	-government revenue -ODA -enterprises -PPP	-programmes often underfunded, difficult to expand -improving effectiveness in informal economy
Entrepreneurship incentives (capital and skills)	-government revenue -ODA -private resources	-only few countries have existing programmes, not always effective
Extending unemployment benefits	-government revenue	-not applicable in countries without UB scheme

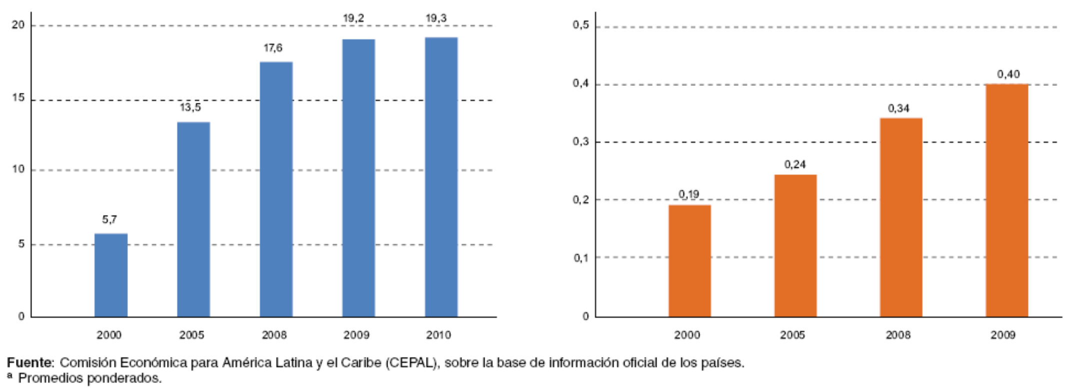
Source: Based on table 1 in Cazes et al. 2009.

However, building on existing programmes and as part of fiscal stimulus packages, many countries have implemented or expanded LMPs and social protection measures such as conditional cash transfers (CCTs) or public works programmes. Table 3 and 4 present policy tools and selected country evidence on policies implemented by governments in developing countries as a response to the global crisis.[27]

Where unemployment insurance is less developed, social assistance becomes the dominant social protection instrument for providing income support to vulnerable groups.
Latin America consolidated its position as a pioneer in cash transfer programmes, both social pensions (not shown in the graph) as well as conditional cash transfers for families with children (transfers are conditional on school attendance and health check-ups for children), as the following graph shows (figure 9).

Figure 9: Latin America/Caribbean: Coverage of CCT and related public expenditure

A. Coverage, 2000-2010 (% of total population) **B. Expenditure, 2000-2009 (in % of GDP)**



Source: CEPAL 2010b: Graph III:7 (19 countries)

CCTs exist in 19 countries in the region, covering more than 113 million persons or 19.3 per cent of the population (47.5 per cent of the poor) with expenditures of 0.4 per cent of GDP financed through national governments and multilateral credit agencies such as the World Bank and the IDB and some bilateral donors (CEPAL 2010b). Income transfers, especially for lower income groups, have important multiplier effects and stimulate domestic demand and by extension, employment (Berg and Tobin 2011).
In addition to efforts at expanding CCTs as a crisis response, countries in Latin America have implemented the following policies in support of labour markets and the unemployed (Freije-Rodríguez and Murrugarra, CEPAL 2010a):

In **Argentina,** a wide range of measures have been adopted, such as social dialogue and crisis prevention procedures, expansion of funds for the Production Recovery Programme (REPRO) which provides wage subsidies for firms in difficulties ; incentives for formalization (temporary

27 Some measures are more costly than others, but also more rapidly effective and are therefore recommended for the short term (subsidies, benefit extensions, public works), whereas measures aimed at improving firm competitiveness, labour intermediation services, education and training and reformed benefit schemes are more appropriate for a long term crisis scenario (IDB 2009).

reduction of employers' social contributions), a public works programme aiming at creation of cooperatives (*Plan Ingreso Social con Trabajo*); expansion of social protection measures such as social pensions and child benefits (*Asignación Unica por Hijo*) and different programmes providing cash transfers, education and labour market services for unemployed heads of households and unemployed youth without access to contributory unemployment benefit schemes (*Plan Jefas, Plan Familias, Seguro de Capacitación y Empleo, Programa Jóvenes con Más y Mejor Trabajo*).

In **Brazil,** the government extended the unemployment compensation period for two months, covering 600.000 people. Total costs of the programme were R$13.8 billion in 2008 and the additional payment is expected to cost R$2.2 billion, funded from the Worker Protection Fund FAT (*Fundo de Amparo ao Trabalhador*) which might use up to 10% of its technical reserves. The government also increased the minimum salary from R$415 to R$465 (about 6.4%) representing R$24.3 billion in additional government expenditure; a further increase took place in January 2010 to R$ 510 (Berg and Tobin 2011). In terms of social protection, Brazil has important non-contributory transfer programmes such as social pensions (rural pension, social assistance and disability pension BPC) covering 11,6 million persons and the CCT *Bolsa Familia* covering approximately 12,8 million persons in 2010, with total costs of approximately 2.6 per cent of GDP (Berg and Tobin 2011, ILO 2010a).

The former **Chilean** government implemented a new *Youth Employment Subsidy Law*, which stipulates provision of a 30% subsidy of annual income for individuals aged between 18 and 24, with finished secondary education and working in a formal position with monthly incomes below US$ 600. Another law was approved providing for *temporary income tax reductions* for individuals and tax credits for firms that carry out training activities with their workers. An extraordinary benefit of 40,000 pesos (ca. US$ 67) is paid to families and individuals that are beneficiaries of social programmes (Subsidio Familiar, Asignación Familiar, Chile Solidario, Asignación Maternal).
In early 2008, and not related to the current crisis, the Chilean Government had adopted important wage measures such as a bonus payment of 20.000 pesos (ca. 14% of the minimum wage) for workers with low incomes and an increase in the minimum wage from 144'000 to 159'000 pesos (US$ 291 to US$ 321). The 2008 pension reform which gradually expands non-contributory pensions towards the 60 per cent poorest elderly not having access to other pensions is another measure contributing to households' income security and demand stabilization.

Mexico expanded the Temporary Employment Programme (*Programa de Empleo Temporal*, PET) by 2.2 billion pesos (0.02% of GDP), allocated another 2 billion pesos (a 0.02% of GDP) for employment subsidies to exporting firms; extended the ability to withdraw funds from retirement accounts for unemployed individuals; extended coverage of health insurance up to six months after dismissal for unemployed workers and their families; allocated 1.25 billion pesos (0.01% of GDP) for enhancing the employment intermediation services of the Labour Secretary; and announced a national infrastructure programme for 2009 of 570 billion pesos (5.87% of GDP) based on both public and private investors. Mexico is also a pioneer with regard to CCT programmes (*Progresa-Oportunidades*), and the government has expanded the programme funded by a World Bank loan as part of the crisis response policies.

South Africa as the country with one of the highest unemployment rates in the world (above 25 per cent in 2010) has dedicated the highest share of its fiscal stimulus package to social protection measures (56 per cent, see Zhang et al. 2010). As other middle income countries in

Latin America, South Africa had already important social programmes in place which could be easily scaled up during the crisis (child support grant, social pension, free basic services etc.). The *Expanded Public Works Programme* which started in 2004 was equally scaled up reaching expenditures of 1 per cent of GDP in 2009; social partners agreed on a second phase of the programme, with the aim to create around 2 million new full-time jobs over the 5-year period from 2009-14. Another flagship programme is the *Training Layoff Scheme* which started in September 2009, providing skills and training and an allowance to employees during a temporary layoff period (up to maximum of six months) during which they remain formally employed. The scheme is funded from the National Jobs Fund (receiving funds from the Unemployment Insurance Fund and the National Skills Fund) and employers are responsible for paying social benefits (ILO 2010b).

India's response to the crisis has focused on growth enhancing economic measures such as tax reductions, injection of liquidity and promotion of investment. LMPs and social protection policies have focused on existing flagship programmes such as the National Rural Employment Guarantee Act (NREGA) providing rural households with 100 days of guaranteed wage work per year. In 2008, 32 million families received work (ILO 2010c). The government funds a similar programme for the urban sector (*Swarna Jayanti Shahari Rojgar Yojana* Scheme) as well as social infrastructure development and skills development programmes.

Table 4 provides an overview summary of the presented case studies including some information on costs and funding sources. Social policy responses including LMPs that were implemented in the countries fall into the broad categories listed in table 3, but the specific policy mix in each country depends on the particular crisis impact, existing social programmes and institutions, the size of fiscal stimulus packages and on fiscal space beyond the short term. Revenue sources and volumes vary also according to country context, with those countries depending on mineral rents, remittances, and trade revenues being most negatively affected. Access to domestic and external borrowing has been important in terms of funding fiscal stimulus measures, but some countries with less policy space in this area, for example Argentina, have resorted to exceptional measures (pension renationalization) that have increased fiscal space, whereas others (Chile) could make use of institutionalized anti-cyclical fiscal policy rules. In Latin America, as a result of the implemented measures in combination with the strong pre-crisis position and positive external demand for exporters, growth and employment levels recovered quickly (with Central America and the Caribbean still lagging behind), although, as stated above, some basic questions about medium term implications of the crisis remain (Marinakis 2011, Ocampo 2009). In Latin America and in other contexts where open unemployment is a deeply entrenched structural problem (South Africa) or where informality is the reality for a substantive part of the population (India and many LICs), the challenge is to move towards a more inclusive growth model, with less residual and fragmented social policies and more integrated labour markets providing decent work.

Table 4: Social Policy and Labour Market Responses to the Crisis, selected countries (2008-10)

Country	LMP	Social Protection	Financing
Argentina	-Public employment services: LM intermediation, training programmes -Expansion of Production Recovery Programme (REPRO): subsidized reduction in working hours; subsidy of 10% of labour cost for 12 months extendable by a further 12 months (at 5%). - Promotion of worker formalization (through incentives, e.g. pension moratorium) -wage increases for public sector employees - Plan to create 100.000 jobs (cooperatives: Plan Ingreso Social con Trabajo)	-expansion non-contributory pensions -coverage expansion child benefits (current cost non-contributory part 0.55% GDP) -public (employment) programmes Jefas, and follow-up plans Plan Familias, Training and Employment Insurance (non-contributory), Youth Work Programme	-government funds (including National Social Security Funds - nationalization of private pension funds in 2008: additional contribution flows 1.5% GDP p.a., accumulated pension stock ca. 10 % GDP; 30% of export tax on soy beans distributed to provinces) -World Bank loans
Brazil	-minimum wage adjustment -extension of unemployment benefit (2 months)	-increase of Bolsa Familia value (CCT) - expansion of Bolsa Familia to an additional 1.3 million families (total cost 0.4% GDP) -housing programme 1 million units (Minha Casa, Minha Vida (cost 1.2% GDP)	-FAT (Fundo de Amparo ao Trabalhador), might use up to 10% of its technical reserves -public debt -general revenues
Chile	-Employment subsidy for low-wage young workers, as well as additional cash transfers to low income households. Payment of US$ 67 per families/individuals participating in social programmes, March 2009 -Extension of Unemployment Solidarity Fund to provide access for all unemployed workers -increase of minimum wage (2008)		-Contingency Fund activated when unemployment rate rises above 10% (regional levels) -unemployment funds, unemployment solidarity fund -enterprises -general revenues
Mexico	-The temporary employment programme at the federal level was expanded by 64% over what had been planned, bringing it up to US$ 182 million in 2009. -US$ 140 million earmarked under the Employment Preservation Programme for protecting employment in vulnerable businesses. -Support to unemployed urban workers (US$110 per month) for a period of four to six months through the Urban Temporary Employment Programme. -minimum wage increase -support for workers in tourism -short-term training and capacity building SMEs	-extended ability to withdraw funds from retirement accounts for unemployed -extension of health coverage up to 6 months for unemployed -*Oportunidades* CCT expanded by 1'500 million US$ (World Bank financed) -nutrition programme	-loan World Bank and IDB -contingent credit line IMF, special drawing rights -government funds (including from oil revenue stabilization fund) -US$ 6'000 million cut in public expenditure -private pension accounts -2010: tax reform, further expenditure cuts, price increases for fuel
India	-increase in budget allocations for large flagship programmes for employment, education and health	-Further extension of National Rural Employment Guarantee Act (cost approx. 0.6% GDP)	-NREGA: central government (wages, ¾ material) and states (1/4 material, unemployment allowance)
South Africa	-Public investment programme -Expanded Public Works Programme (EPWP) -Training Layoff Scheme	-raising means-test income threshold for social programmes -age extension of child grant -equalized minimum age for men and women for social pension	-Government Revenues -National Jobs Fund (contributions from Unemployment Insurance Fund, National Skills Fund)

Source: own compilation based on Marinakis and Velàsquez 2010; Frejie-Rodriguez and Murrugarra 2009; Ferreira and Schady 2009, CEPAL 2010a, ILO 2010b, Rial 2009

6. Conclusions and policy implications

In the current global context and despite some promising signs of recovery, there is a continued need to boost economic growth and to invest in employment and social protection. At the same time, many countries seem to have exhausted their fiscal space to fund these measures and are starting to cut expenditures. If there is some truth in the argument of a benefit of crisis, the recent experience should encourage policy makers to advance further in institutionalizing social and labour market policies and progressive financing systems. To prevent a jobless recovery, more funds have to be allocated to economic and social policies that foster employment and protect household income. It is also worth mentioning that fiscal constraints do not justify that countries do not secure certain minimum standards in terms of social security as enshrined in the international human rights framework and other conventions (ILO 2010a, Sepúlveda 2011).

Ideally, revenue and expenditure policies for social provisioning should respond to the principles of efficiency, equity and democratic accountability. They should be embedded in and support a broader macroeconomic framework that is conducive to productive investment and employment. In a nutshell, the challenge is to build social programmes based on financial arrangements that are themselves sustainable in fiscal and political terms, equitable and conducive to economic development. This paper has argued that domestic financing instruments, such as taxation and social insurance, if well designed, are best suited to create these synergies, to strengthen democracy and social solidarity, to support a social contract among citizens and with their political leaders, and to provide the latter with more policy space. Private and external resources (including mineral rents), although second best from an economic and equity point of view, have the potential to complement public domestic financing, as does domestic and external borrowing in times of crisis.

Financing policies have a political and social dimension

Whether improved funding opportunities eventually increase social expenditures, are channelled into productive investment, pile up in central bank reserves, or reduce public debt (not to mention corruption and other types of illegal appropriation of public funds) is the outcome of complex political and social processes. The more democratic, accountable and transparent the political process is, the more likely social programmes and the corresponding budget allocations will reflect the public interest and a reasonable balance between transfers and investment, economic and social spending. In times of crisis, hard choices have to be made and the immediate need to stabilize the financial economy often works to the detriment of social policies and employment concerns. It is therefore important that international organizations and civil society actors continue to alert policy makers that the economic, social and political costs of this neglect can be enormous.

It is further important to keep in mind that the way in which social expenditure is financed is not neutral in its distributional or productive effects. Reforms entail potential losers and winners, which may or may not correspond to groups benefiting from public transfer schemes and social investments. The macroeconomic effects of different financing sources, such as the impact on domestic demand, investment and savings, monetary stability and currency risks, have to be considered carefully.[28] Similarly, the implementation of progressive direct taxes on wealth and income tends to create opposition from influential social groups and can lead to reform blockades. Therefore, the more universal social programmes are, the easier it is to find

[28] Vos et al. 2008.

convincing arguments for progressive funding structures, which are built on relatively greater contributions from higher income groups.

Anchor a country's social policy system with domestic sources of financing

Like the budget process, financing structures are inherently political. The source of funding has profound implications for the political economy of building and sustaining social policies. External sources of funding, in particular ODA, are only sustainable as long as donor commitments last. Internal sources, on the other hand, if designed effectively, have the potential to create intergenerational and interclass linkages that are more difficult to break over the long term. These domestic financing structures are the core or the anchor of social policy systems. Domestic financing instruments are levied on national economic activity and they redistribute income and risks among different groups. Macroeconomic policies that foster income creation and decent, formal employment are therefore central to any successful fiscal strategy.

Develop a clear strategy for financing social policies

This strategy should build on reliable calculations of the estimated costs of planned programmes over longer periods and take into account different scenarios; evaluate different financing techniques and assess their pros and cons from a political, economic and social point of view; analyse any relevant experiences in other countries; and seek early dialogue with relevant stakeholders, including social and finance ministries, external donors, international organizations, social partners and civil society organizations, and last, but not least, include a contingency plan for a crisis situation.

Avoid costly short-term measures and plan for the future

Many developing countries are actually living in a situation of permanent crisis or crises, which has major negative implications for sustainable and equitable long term development. This crisis should not be used (as has happened in the past) to justify measures with adverse long term consequences for state capacity, poverty reduction and social development, but to the contrary, pave the way for more inclusive economic and social policies.

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