

Wolfgang Scholz
Social Security Department
International Labour Office
Geneva, Switzerland
scholz@ilo.org

Conference on Social Impacts of the Economic Crisis in Eastern Europe, Turkey and
Central Asia

Almaty, Kazakhstan, 7-8 December 2009

Session: Social Protection (2nd day; morning session)

Background notes for Panel Statement

After the conference, thus far, discussed the social impact of the financial crisis mainly under labour market and short term poverty aspects, I would like to make 13 remarks with a perspective that, hopefully, provides some longer term social policy direction.

1. Minimum institutional requirements for sustainable market economies are:
 - (i) (Schumpeterian) entrepreneurs,
 - (ii) guaranteed ownership rights,
 - (iii) an employable workforce,
 - (iv) financial institutions, and
 - (v) social security¹.
2. Why is social security included in this list? Several explanations have been tried – the most convincing are the following:

¹ In these speaking notes we use “social security” and “social protection” widely synonymously; we are, of course, fully aware of the distinction that is often made, and often must be made, in scholarly discussions and publications.

- a) Social protection, as a redistributive mechanism, guarantees maximum mass consumption;
 - b) It does so, in principle, without inflationary effects;
 - c) Capital-based market economies need social security to **buy-out** non-productive labour from the production process (or, depending on circumstances, to **buy-in** productive labour); examples:
 - (1) Old-age and disability pensions are used to buy-out those persons from the production process that have turned non-productive for good;
 - (2) Unemployment benefits, sickness benefits and similar short-term benefits are used to buy-out persons that have temporarily turned non-productive;
 - (3) Family benefits usually function the other way around: they are often designed such that they buy-in productive labour into the production process (for example, kindergartens allow parents to join the labour market); child benefits, as a specific form of family benefits, function in a similar way but with a long-term perspective: child benefits are paid to persons who are not yet productive but who are expected to be so in future; this is why child benefit payment is sometimes made conditional on school attendance; according to their nature, child benefits are usually long-term benefits (like pension payments).
3. Why are economies ready to bear the costs related to social security? They do it, and only do it, because and if the overall productivity of the economy is higher, after the buy-out / buy-in, than before. Whether this is the case in a real situation is a question of concrete circumstances and remains to be verified case by case, and again and again.
4. It is therefore, in capital-based market economies, meaningless to distinguish between productive and non-productive social protection: all social spending is productive; of course, the implicit productivity gains through social security may vary substantially from economy to economy (depending on

circumstances, as said), and sometimes, indeed, the productivity gain may be close to zero.

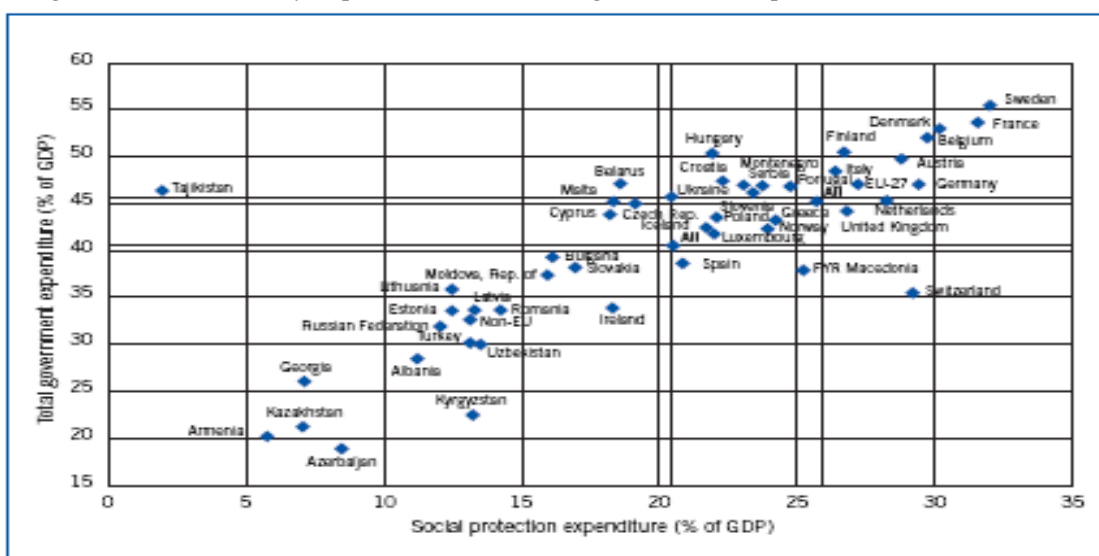
5. Individuals (incl. households & enterprises) are myopic; within their micro-environments they are unable to realize directly the productivity enhancing function of social protection. This is the core reason why organizing social protection is the obligation of the state.
6. This analysis has **implications**:
 - (1) Although the state has to organize social security this does not suggest that the government knows best; to the contrary: the government, in its endeavours to support the economy's overall productivity, has to rely on information which is only available from the main production factors, i.e. capital and labour (employer and employee organisations). Here is a core economic reason why the ILO, quite rightly, promotes tripartite social dialogue;
 - (2) Governments pursuing a policy of long-term sustainable economic growth without social security forego the additional productivity gains of social protection and in case the strategy turns out unsuccessful, societies have no means ready to counterbalance the sudden crisis effects;
 - (3) Governments privatising existing social security systems or governments aiming at building social security on the basis of private arrangements give social security into the hands of those myopic entities which, by their very nature, are unable to manage social security within the productivity nexus; in so doing, governments decide not to make use of the productivity enhancing effects of social protection;
 - (4) Indeed, often governments might not be able to implement, and make productively use of social security as described; reason might be that the required dialogue structures with labour and capital do not exist; or achieved general economic levels are still very low; in such cases implementation of social protection must be based on considerations other than the economic productivity argument; such other considerations are

fundamental human rights, or considerations of a political nature; in such cases social protection often takes the form of “state-organized” charity, e.g. through so-called targeted benefits (of which we know that they usually do not function) – and which I decline to call social protection;

7. History indicates that improvements in social legislation, in social governance, in scope and depth of social security programmes, have often been linked to political or economic events or crises; examples:
 - (1) *Bismarck* established the German system as a countermeasure to the increasingly stronger labour movement at the end of the 19th century and as an institutional means to strengthen the unity of the young *Reich*;
 - (2) *Roosevelt* established U. S. social security in the 1930s as part of the New Deal;
 - (3) *Beveridge* designed the British system in reflection to WWII but also in order to overcome the miseries of the traditional Poor Law;
 - (4) and the success of the *welfare state concept after WWII* cannot be fully understood without taking into account its use as a political instrument in the antagonisms arising from the post-war divide.
8. With most of the economies represented in the Conference suddenly collapsing in the 1990s, existing social security structures could not easily adapt to the new economic and societal conditions, especially it turned out difficult, most often impossible in hyper-inflationary environments, to assume social security's role of productivity enhancement. Instead, social security was often being transformed into “mere” cash transfer systems. This helped to maintain minimum consumption and production levels in the (at that time) ailing economies, but had only close-to-zero productivity effects. Later, many governments largely followed World Bank advice and, while privatising and individualising essential elements of the public social security systems, explicitly gave out of hands the option, but also: the responsibility, of using social security productively.

9. Many countries of the Region are still in a search process of finding that design of social protection which most appropriately incorporates the Region's specific societal and economic needs. In historical terms this is still a young process – while needs of people are of course current and instantaneous needs.
10. Indeed, the current crisis might help to undertake in-depth reviews of the current state of the Region's social systems, of the societal and economic roles of social security, to re-formulate or fully renovate programmes, and to start pursuing revised directions – a process, which might include transforming structures that were introduced in the rush ideology of the 1990s but which meanwhile turn out to be socially and economically ineffective.
11. Revision of former policies might indeed be required given the low overall spending on social protection of the Region's countries (in relation to their economic capacities).

Figure: Social security expenditure and total government expenditure (2005)



Note: Two figures are given for "All" (all countries). The higher figure is the average for all countries weighted by GDP and the lower figure is weighted by population.

Source: ILO calculations based on ILO Social Security Inquiry database and OECD, ADB and IMF data.

Countries that spend well above 10 to 15 per cent of GDP on social security usually meet the minimum requirements of ILO Convention No. 102.

Also, they cover larger majorities of the population. The gap in coverage in low-spending countries is however substantial. For example, estimates by the Asian Development Bank (ADB) show that population coverage (beneficiaries as a percentage of target groups) is only 67 per cent in Kyrgyzstan, 55 per cent in Azerbaijan, 44 per cent in Kazakhstan, 40 per cent in Uzbekistan, 38 per cent in Tajikistan and 36 per cent in Armenia.

In many countries public social security expenditure is - for good reasons - heavily dominated by spending on pensions and health care. There is evidence that this is also the case in many non-EU countries, including the ones represented in the Conference. Regrettably, not much information is available about the structure of the social budgets of these countries. There is however a risk that expenditure on important programmes, such as unemployment benefits, family programmes, housing programmes or programmes addressing social exclusion, is low, if at all existent.

12. Based on this evidence there is reason to resume policies aiming at the complementary objectives of social development and economic efficiency. ILO experience and mandate strongly suggest that reform processes aimed at achieving a new policy paradigm should be based on the following five principles²:
 - (1) Universal coverage of income security and health systems:
All residents must have access to benefits ensuring income security and comprehensive medical care.
 - (2) Social benefits and protection against poverty as a right:
Entitlement to benefits must be specified precisely as predictable right of residents and / or contributors; benefits must provide effective protection against poverty; if they are based on contributions or earmarked taxes,

² International Labour Office: Delivering decent work in Europe and Central Asia. Report of the Director-General, Volume I, Part 2. Eighth European Regional Meeting, Lisbon, February 2009.

minimum benefit levels must at least comply with the Convention No. 102.

- (3) Sound financing:
Schemes must be financed so as to maintain adequate fiscal space for the social security system as a whole and for individual schemes in particular, in order to avoid uncertainty about their long-term financial viability.
- (4) Actuarial equivalence of contributions and benefit levels:
In the case of savings-based schemes the State (or regulatory mechanisms) must guarantee minimum replacement rates for benefits or minimum rates of return in order to adequately reflect the level of the contributions paid.
- (5) Responsibility for governance:
The State must remain the ultimate guarantor of social security rights, while financiers and beneficiaries should participate in their governance.

The *figure* (above) shows that both high and low spending country groups include countries with good and others with less convincing economic performance. The often cited trade-off between economic performance and social expenditure does not therefore hold. The huge relative (to GDP) spending differences cannot be attributed exclusively to economic performance, but indicate that countries have substantial policy space to shape their social protection schemes.

- 13. Like many others, also the countries in the Region are negatively affected as a result of the global crisis. Like many others, these countries must again take decisions about their future economic and social policies, and, in that context, about their social security systems.

It may be helpful, in this context, to remind ourselves of three basic facts:

- (1) Technical knowledge about the operational functioning of social security systems is widely available; no further research is needed in that respect.

- (2) More or less everything is known (of what must be known) about the interaction of social protection with other policy fields, with the economy and with the society at large – research in all these areas has been done, the results are available.
- (3) The implementation of social security, i.e. the required up-front investment, is cheap. In comparison to the enormous relative amounts of resources that would have been required 100 years ago, the implementation of fully operating social security systems (with full population coverage) can nowadays be done within short time and at low costs – which is the case not the least because of modern administrative data processing and communications technology but also because decision makers have instantaneous worldwide access to the relevant information and, last but not least, can rely on the support of much better educated and informed administrations.

In other words, it is time to implement social security. We all observe a world-wide interest in, and moves towards implementation of, social security. We should therefore not miss the opportunities resulting from this window which is as widely open as it has not been for years. We should not try to re-invent the wheel, but assemble it, put the wheel at the right place and get social security moving – not the least in order to be better prepared for the next crisis to come.