Session 4: Achieving income-led growth

Social Security: Three lessons from the global crisis

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Abstract

Three lessons can be drawn from the global crisis with respect to social security: (1) People covered by different – with respect to financing, design and coverage – social security arrangements are differently exposed to economic shocks; (2) social security – with adequate financing, design and coverage – acts as economic and social stabilizer during the crisis; and (3) while the crisis opened a window of opportunity for initiatives aimed at extending effective social security coverage globally and in particular in low-income countries, still more political will has to be created both nationally and internationally to open the necessary fiscal space.
Social security: Three lessons from the global crisis

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1. Introduction

The global crisis gave a new impetus to the global discussion on social security policies. Countries having social security programmes in place strongly relied on those as part of their stimulus packages as automatic stabilizers. In countries affected by the crisis without adequate social security mechanisms, the need to develop social security became even more apparent. As a result, a number of social protection policy initiatives have been initiated or stepped up at the national, regional and global level, including the UN Social Protection Floor Initiative and the Global Jobs Pact.

Already before the crisis, positive changes have been initiated in many developing countries. In a number of middle income, as well as in some low income countries, new policies were implemented (or at least policy debates started) aiming at covering large portions of the uncovered population, or at least targeting the poorest and most vulnerable.

Still, a large social security coverage deficit is prevailing, largely concentrated in low and middle income countries (ILO, 2010a). This social security coverage deficit is one of the main obstacles to achieve the Millennium Development Goals and related development objectives aimed at fair globalization and decent work. At the same time, an intense debate on social and economic adequacy and financial sustainability of the existing levels of coverage in some OECD countries (ILO, 2010c). A number of recent reforms implemented in developed countries are significantly weakening the levels of protection (in particular for those with broken, shorter careers and in irregular employment status).

Against this background, this paper will focus on three lessons that can be drawn from the global experience of crisis response:

- People covered by different – with respect to financing, design and coverage – social security arrangements are differently exposed to economic shocks (Section 2.1).
- Social security – with adequate financing, design and coverage – acts as economic and social stabilizer during crises (Section 2.2).
- While the crisis opened a window of opportunity for initiatives aimed at extending effective social security coverage globally and in particular in low-income countries, still more political will has to be created both nationally and internationally to open the necessary fiscal space (Section 2.3).

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This brief review reflects some of the issues reviewed in the ILO’s Recurrent Discussion Report on Social Protection (Social Security) which is currently being prepared for the ILC 2011 (ILO, forthcoming), as well as on analysis included in other recent ILO social security publications.

2. Lessons from the crisis

2.1. The crisis revealed the exposure of different types of social security schemes to economic shocks

Our first lesson from the global crisis underlines the need for guarantees in the design and financing arrangements of social security schemes. This has become particularly evident in the case of pension schemes. Recent pension reforms in some countries have shifted financial risks to workers, which have resulted in undue exposure to the volatility of financial markets. Moreover, social security finances are – directly or indirectly – negatively impacted by rising unemployment, underemployment and an informalization of employment. The crisis has highlighted the need to counterbalance these risks through appropriate guarantees.

Much attention has been paid to the effect of the global crisis on pension finances. The investment returns of pension funds around the world have markedly dropped during the crisis (Figure 1), leading in many countries to a contraction of pension reserves.²

Figure 1: Impact of economic and financial crisis on value of pension reserves during crisis and recovery: nominal investment returns 2008 and 2008-09

Note: * Data for 2009 refer to January to June only. Data for USA include IRAs. Source: ILO, forthcoming; based on OECD, 2010: Pensions markets in focus, July 2010 (Issue 7) (Paris: OECD), Statistical Tables.

² There has been a number of accounts of the drop in returns and the losses of pension funds, see e.g. OECD (2010a, 2010b); World Bank (2010); Bonnet et al. (2010); Pino and Yermo (2010).
Even though the rates of return of many pension funds have recovered in the meantime, there is no reason for complacency. This rebound veils the fact that many workers and retirees, especially cohorts retiring during or shortly after the crisis, have had to face markedly reduced pension levels, given that they have not had the chance to wait for a full recovery of pension levels (Bonnet et al., 2010). Moreover, the crisis has brought to light the volatility of investment returns, the level of financial risks carried by workers and the resulting level of insecurity and inequity (Burtless, 2000; 2009). It will take a long time until pension funds will not only have recovered losses, but also to compensate for the years of lost contributions paid by the insured population (Bluhm, forthcoming). As a result, in many countries, pension incomes are likely to display higher levels of variance and volatility than before. In some countries, this may result in decreasing relative income levels of pensioners, and higher poverty risks for older women and men.

The crisis has exposed the increased vulnerability of privatized pension schemes to the ups and downs of the financial markets. By this token, it has temporarily attenuated the wide-spread enthusiasm for the privatization of pension schemes, which had inspired a series of pension reforms in various parts of the world, namely in Latin America and Central and Eastern Europe during the last three decades. While disenchantment with pension privatization policies has started well before the crisis, even amongst previous supporters of these policies (e.g. World Bank, 2006), in response to shrinking coverage, eroding benefit levels and high fiscal cost, the crisis has provided the impetus for some countries (e.g. Argentina, Bolivia, Hungary, Poland) to reverse some of the previous reforms. More efforts are needed, however, to strengthen appropriate guarantees which would ensure at least a minimum level of income security for workers. International labour standards provide essential guidance in this respect.

The crisis also had a wider effect on other types of social security schemes. Rising levels of unemployment, underemployment or an informalisation of employment lead to a contraction in contribution and tax revenue, and as a consequence, – unless appropriate provisions have been taken – have narrowed the financial scope of manoeuvre available to finance social security benefits, at a time when these are most needed (e.g. Orton, 2010). The crisis has highlighted the need to review social security policies and governance structures in order to ensure that the design and financial architecture of social security systems are conducive to ensuring sufficient stability and flexibility even during major shocks.

2.2. Recognition of social security as social and economic stabilizer

Our second lesson of the crisis highlights the critical role of social security programmes as economic stabilizers, which goes beyond ad-hoc crisis response. While this function has attracted much attention during the global crisis, it is important to note that this function is not only relevant during crises, but is equally important as a permanent stabilizing element ensuring balanced economic growth and social cohesion, and facilitating adjustment to structural change. This view seems to have found wider support, as demonstrated by a growing number of middle-income countries which are considering the introduction of unemployment insurance schemes. However, fiscal austerity measures may obstruct a systematic implementation of these policies in the short and medium term.

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3 See e.g. World Bank (1994; 2005), for critical reviews of these policies, see Gillion et al. (2000) and Diop (2009).
In the wake of the crisis, social security has been widely recognized as an automatic economic and social stabilizer. This has been the case – in different ways – in countries on all levels of development. A number of country examples show how social security programmes were successfully used to alleviate the impact of the crisis on employment and incomes, and to sustain aggregate demand and buffer economic growth. Social security played a strong role in the crisis response strategies of many OECD and G20 countries, which maintained or even expanded social security programmes. According to recent reviews of fiscal stimulus packages, some countries, including South Africa, the United States, the Russian Federation, Italy and the Netherlands, allocated more than 30 percent of their stimulus packages on discretionary social protection expenditure (ILO, 2010c, pp.7). A particular important role has been played by unemployment benefits, including partial unemployment benefits, and social assistance schemes.

The crisis has illustrated the critical importance of unemployment benefits in ensuring income security for workers, facilitating job matching and skills upgrading (through close coordination with employment services and other active labour market policies), and stabilizing aggregate demand. Many countries have taken ad hoc measures to expand coverage, adjust benefit levels and extend the duration of benefit payment. A variety of measures were taken, such as relaxing eligibility conditions, extending the maximum duration of payment of benefits, increasing benefit levels and reducing contribution rates (ILO, 2010b, pp.15-25). Unemployment schemes proved to be beneficial not only in OECD countries with traditionally well-institutionalized schemes, but also in those countries whose unemployment insurance schemes were introduced more recently, such as Argentina, Bahrain and the Republic of Korea (Prasad and Gerecke, 2009; Behrendt et al., 2009). Unemployment assistance programmes (e.g. local programmes in Mexico and the programme for fishers in Brazil) have also played a critical role in ensuring a minimum level of income security for workers at the margins of the formal economy. Overall, however, statutory unemployment benefit programmes exist in less than half of all countries, among which few middle or low income countries (ILO, 2010a; Berg and Salerno, 2008).

Figure 2: Partial unemployment benefits in Germany during the global crisis

Source: ILO, forthcoming, based on statistics from the German Federal Employment Agency and the National Statistical Office.
Partial unemployment benefits have also proven to be of particular importance. By allowing a reduction in working time while at the same time maintaining income security for workers, these benefits helped workers and employers to maintain their employment relationship throughout the crisis (ILO, 2010e). This has contained the rise in unemployment rates caused by the fall in demand, and has enabled employers to quickly react as markets picked up again (Figure 2 for evidence from Germany).

While unemployment benefit schemes have attracted most attention as automatic stabilizers, other social security programmes play a similar role. For example, social assistance programmes play an important role in preventing or alleviating vulnerability and poverty on the micro-level, and a drop in aggregate demand on the macro level. Programmes that facilitate access to health services can help to prevent situations whereby the loss of a job is coupled with the loss of access to health services (e.g. through the loss of an employer-sponsored health insurance plan). Both types of programmes are important elements of crisis response in the short run, but they also play a major role in preventing negative long-term effects of a crisis on people’s health, well-being and eventually also future productivity.

The crisis has confirmed again that demand-strengthening crisis response strategies can be implemented much more quickly in countries where social security programmes, including administrative structures, are already in place and can be easily extended (Bonnet et al., 2010). This has been demonstrated in the case of the global financial and economic crisis, but also in earlier economic crises as well as crises of other nature. For example, Sri Lanka after the 2006 Tsunami disaster thanks to relative broad coverage and access to health care services there, could handle at least some aspects of the situation more effectively than some other countries affected by this or similar natural disasters.

2.3. Opening a window of opportunity for the extension of social security

Our third lesson from the crisis stresses the opportunities arising from the crisis. It opened a window of opportunity to firmly anchor social protection policies as an essential component of national economic and social development strategies, and to harness the necessary international support for this matter. However, more intensive efforts are still necessary to mobilize sustainable political will to create the necessary fiscal space primarily at the national level, but also at the international level.

The global crisis has amplified the attention to national efforts to implement social protection policies as a key element of development strategies. Prominent examples in middle income countries include the conditional cash transfer programmes Bolsa Familia in Brazil and Oportunidades/Progres in Mexico, recent pension and other reforms in Chile or the high-coverage social grants programme in South Africa including non-contributory benefits for children, disabled and elderly (see ILO, 2010b). Similar efforts to introduce and extend social protection programmes have been undertaken or are under debate also in a number of low-income countries, including the social pensions in Nepal and Thailand, extension of target cash social assistance (“food subsidy”) in Mozambique, and cash transfers in Zambia. Evaluations of these programmes show strong and largely positive effects on human development, poverty alleviation, employment and local economic development (ILO, 2010f). While this attention had already gained momentum before the crisis, and was also reflected in a number of regional policy documents (e.g. Livingstone
Declaration, 2006; African Union Social Policy Framework, 2009), the crisis contributed to moving this issue high on the international agenda.

These efforts have gained wide international attention and support. Social protection is now widely accepted as one key element of national crisis response (and prevention) policies. This has been marked by the inclusion of the Social Protection Floor concept in the Global Jobs Pact (ILO, 2009; UN ECOSOC, 2009) and as one of eight United Nations crisis response initiatives (UN CEB, 2009). The Social Protection Floor Initiative of the United Nations, co-led by the ILO and the WHO, aims at promoting a set of guarantees aiming at ensuring universal access to at least a nationally defined set of essential health care services, and at least a basic level of income security for children, older women and men, people with disabilities, and adapted programmes for those in active age who are unable to earn sufficient income in the labour market. Several G-20 documents have also highlighted the role of social protection as an element of national crisis response policies and wider social and economic development.

If the Social Protection Floor reflects the horizontal dimension in the extension of social security, it is equally important to step up efforts to strengthen the vertical extension of social security through progressively higher levels of protection (ILO, forthcoming). The crisis has highlighted the necessity to strengthen guarantees, considering the higher levels of risk workers are exposed to after recent pension reforms in many countries. International social security standards provide essential guidance in this matter and can be used as benchmarks to safeguard at least a minimum level of such guarantees.4

3. Policy implications and research gaps

The lessons from the global crisis have several implications for future social security policies, and wider social and economic policies. The most fundamental implication is the call for a new global development paradigm focusing on income-led growth, which has several implications for social protection and wider social and economic policies. The necessary change in policies takes place in a context of widespread fiscal austerity policies which might obstruct the extension of social security. This requires a clear prioritization of social security needs in policy decisions at the national and international level.

3.1. Income-led growth requires strong and efficient social security guarantees

The lessons from the crisis call for a new development paradigm which reflects a more balanced understanding of the interdependency of economic and social development. The failure of the export-led growth models in a context of a fairly unchecked globalization has forcefully underlined the need to develop policies which would ensure that the benefits of globalization are more widely shared and more equitably distributed. While the export-led growth model have overemphasized export sectors, depressed wages and incomes, and exacerbated income inequality (WCSDG, 2004; IILS, 2008), an income-led growth model gives more emphasis on domestic consumption

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4 See e.g. the discussion on the practical application of such benchmarks in multi-pillar pension schemes in Drouin and Cichon (2009).
supported by productive employment, fair wages and working conditions, and adequate social protection.

A number of countries have moved towards income-led growth strategies during recent years, and already follow an income-led growth strategy with a strong social protection component. Brazil has followed a strategy of extending non-contributory social security benefits for the poor, combined with higher minimum wages. China has extended both contributory and non-contributory social security programmes in many provinces, and facilitated access to health care. Thailand’s policy of granting universal access to health care and extending cash transfer programmes is equally notable, as are India’s policy initiatives for the extension of social security benefits to unorganized workers. While it is too early for a full assessment, there is growing evidence that these policies have contributed to boosting resilience against the effects of the global crisis.

Income-led growth requires strong social security guarantees which can provide at least a minimum level of income security and access to social services, and thus contribute to achieving higher levels of health, education and productive employment in the short and medium term. These are the core of the Social Protection Floor Initiative. In addition, international labour standards play a critical – albeit often underestimated – role in setting internationally accepted benchmarks for such guarantees. These are critical in times of crisis and structural change, yet more research would be needed to assess the role of those standards in specific national contexts of acute crisis and structural change, and to develop proposals on how these can be applied more effectively.

Rights-based approaches to the extension of social security coverage therefore are critical to underpin future economic and social development (Hagemejer, 2009). These go beyond the provision of safety nets, and require legislative foundations defining individual entitlements, clear and transparent eligibility criteria, rights of appeal as well as adequate sources of funding. Such approaches are favoured by policies driven by national strategies based on a broad social dialogue, and efficient institutional framework funded by reliable sources. In many developing countries, however, many of the new social protection programmes are still limited to pilot projects and temporary ad-hoc support for which future funding perspectives, in particular with respect to incorporating these programmes into national policies, are uncertain. More efforts are needed to ensure that these programmes become an integral part of national policies and budgets.

3.2. Prioritizing social security in the context of fiscal austerity

The aftermath of the financial crisis has left many countries with large and partly further growing government deficits. IMF estimates show increasing levels of public debt in the large majority of surveyed counties (see Figure 3).
The surge in public deficits increases the pressure to contain public expenditure. Obviously, social security expenditure in many countries is one of the targets of possible curtailments, along with public investments and public sector wages. A premature consolidation of public expenditure may however lead to pro-cyclical contractions of demand and delayed investments in infrastructure, with negative effects on long-term growth and social cohesion. Such effects may be exacerbated by a structural bias in fiscal consolidation measures in many countries, which combine cuts in social security and labour market spending programmes and tax cuts for high-income earners and companies, which negatively affect low income earners and the middle classes (IILS, 2010, pp. 57-75). Paradoxically, in many countries post crisis fiscal consolidation is followed not only by temporary cuts in social spending, but also in some cases by measures not only aimed at cost-cutting but also at trimming down previously achieved levels of protection.

While there has been growing recognition of the need to prioritize social security spending and to increase the fiscal space for social security in many countries at all levels of development, the pressure on public budgets may close this window of opportunity prematurely. Some countries, however, have already embarked on large retrenchment measures in order to contain their public deficits (e.g. Ireland, United Kingdom), and others may follow.

The recognition of the need for effective social spending as a critical element of economic and social policies needs to translate in appropriate policies at the national and international level. The international financial institutions play a particularly critical role in this respect. While in their policy statements, the leaders of the IMF’s and World Bank have acknowledged the objectives of full employment and decent work and the need to better integrate economic and social policies, their institutions’ policy recommendations at the international and country level do not necessarily keep pace. The increased pressure on public budgets may give way to a new wave of poorly balanced

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5 This point can be illustrated by the fact that in the recent World Bank report Global Economic Prospects (2011), the words “protect” or “protection” only occur as part of the term “protectionism”.

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fiscal austerity measures which threaten to undermine the foundations of more balanced economic and social development (Ortiz et al., 2010; Zhang et al., 2010).

In order to maintain, or extend, the fiscal space available for the promotion of policies conducive to income-led growth, more attention needs to be given to the structure of public expenditure and sources of revenue. Public expenditure reviews need to be focused more strongly on the effectiveness and efficiency of allocated expenditure in reaching a country’s strategic objectives, and, if necessary, suggest a revision of spending priorities. What counts is not the level of social expenditure, but its efficient allocation as to effectively reach social outcomes. This puts a strong emphasis on policy design, coordination and coherence. To some extent, the analysis and sharing of good practice experiences can help policy makers to develop new policy options adapted to the particular context. Greater attention is also necessary to ensure that taxation policies and tax administration are in line with these objectives.

If a majority of the world’s poor are now living in middle income countries (Sumner, 2010), increased attention should be focused on the strengthening the domestic resource base through more effective and equitable tax policies and tax administrations, which should help to expand fiscal space for effective social policies. This has important implications for national social and economic policies, as well as on international development policies.

3.3. Moving ahead with the extension of social security

The design of future policies has to take into account the growing evidence demonstrating the important role of social security in supporting long term development of countries, facilitating structural transition and change, cushioning effects of the economic downturns, letting all share the fruits of growth and globalization, reducing poverty and enabling social cohesion. The priority is to establish at least basic social protection to all in need everywhere.

At the same time there, is a need for solutions which would prevent weakening of protection levels below the accepted standards, especially in view of current fiscal austerity policies. Balancing adequacy objectives with challenges coming from demographic ageing, fiscal consolidation and future economic downturns can be only partially solved by changes in the benefit design, eligibility conditions and financing mechanisms. What is required more than ever, is the well governed process of policy making embedded in a well informed social dialogue.

Achieving income-led growth in the context of fiscal austerity requires effective social security policies adapted to the relevant country contexts and closely aligned with economic and other social policies. This is particularly, but not exclusively, important for low- and middle income countries which face particular challenges in the extension of social security to their – still largely uncovered – populations. This entails stronger attention to the impact of social and economic policies – or their absence – on the distribution of resources and economic opportunities in the short, medium and long term, and their implications for social and economic policies in different country contexts.
References


