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Economic Crisis and Beyond: Social Policies for the Recovery

Well-functioning social protection is especially important during times like these. Maintaining and strengthening income transfers and employment-oriented measures in the immediate aftermath of the crisis has helped to smooth family incomes and supported aggregate demand and employment. As economies emerge from recession, such policies remain relevant: they can help deliver a sustained, job-rich and equitable recovery.

Nevertheless, social-protection systems are under pressure. The majority of governments are embarking on fiscal consolidation in an attempt to halt spiralling public debt. Curbing social expenditures, accounting for about half of total public spending in OECD countries, must play a role in the fiscal consolidation process. But this is difficult in the context of elevated need for government support and will have consequences for poverty and inequality. Moreover, the economic crisis and slow recovery have added further urgency to meeting the structural challenges facing welfare states.

Reduced fiscal space

OECD countries have emerged from the economic downturn with different budgetary challenges and fiscal outlooks, but the majority of them face substantial fiscal challenges. The total deficit in OECD countries on average is expected to exceed 6% of GDP in 2011 and total gross government debt in 2011 is projected to reach 100% of GDP. In several countries, debt levels are significantly higher, but in around a third of countries, deficits are likely to be 3% or less of GDP and debt-to-GDP ratios below 60%.

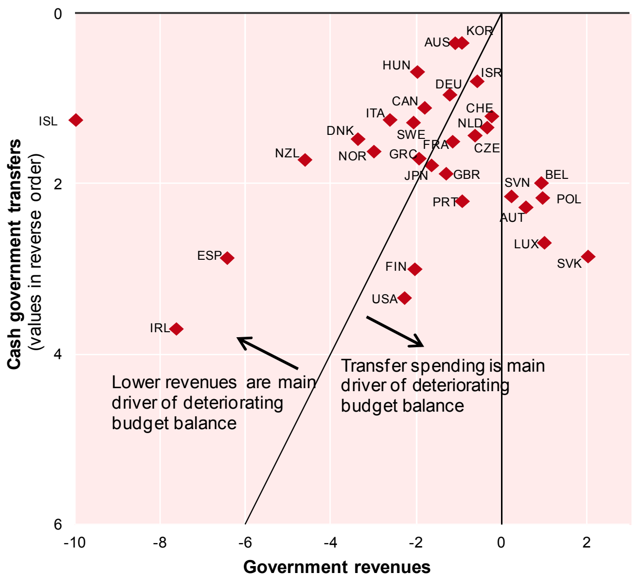
Compared with OECD economies, the public finances of major emerging economies are in better shape. Most of them only faced a short-lived slowdown in economic growth, although public expenditure increased more rapidly than revenues. In emerging G20 economies, budget deficits were held under 4% of GDP in 2010. In some emerging economies, such as India, deficits are much larger, but are not unsustainable as long as economic growth remains high.

The need for and urgency of short-term fiscal consolidation therefore varies. But the greater part of current deficits is believed to be “structural” rather than “cyclical” in many OECD countries. Where this is the case, governments will thus still be spending more than they collect in revenues when the recovery is well entrenched. All countries need to seek ways to maximise value for money in their social protection systems.

Recessions have two deleterious effects on the public finance: lower revenues and higher benefit expenditure, both of which are shown in Figure 1. Real government revenues declined in all but six countries, typically by around 2% of GDP. Real spending on transfers increased in *all* countries, generally by around 1-2% of GDP. The relative importance of the two factors varies, with higher benefit spending dominating in about half of the countries and lower revenues in the other half.

Figure 1. Budget deficits: changes in public transfers and government revenues

Expenditure and revenue changes 2007-10, in percent of 2010 GDP



Information on data for Israel: http://dx.doi.org/10.1787/888932315602

Source: Calculations based on OECD (2010), *Economic Outlook*, No. 88.

Reversing the recent growth in social protection spending would be a big step towards mitigating fiscal problems. And, realistically, necessary social policy reforms in the near future will indeed need to find ways to "do more with less". But cutting social spending alone is not sufficient to restore the public finances to health. Even if transfer spending was to return to pre-crisis levels, this would close less than a third of the budget gap in most countries. Moreover, no OECD country has been able to achieve cuts of this scale when faced with weak growth and high unemployment.

Social policy, poverty and inequality

Widening income inequalities and, in many cases, increasing poverty rates, were evident already before the crisis in many countries. A growing number of households without work results in a steep fall of market incomes among low-income groups. In contrast, incomes in the upper part of the distribution often continue to rise during downturns and when they decline, the relative income losses tend to be smaller than for low-income earners.

Past experience has shown that it is very difficult to cut social expenditures without increasing inequality. Significant short-term savings require benefit cuts, and benefit receipt is naturally concentrated among low-income families. Well-targeted income-support policies are thus important both during economic slumps and recovery. Redistribution strategies based on government transfers alone, however, would be neither effective nor financially sustainable. A key challenge for labour market and social policy is to facilitate and encourage employment growth that benefits low-income groups in particular.

In planning fiscal consolidation measures the relative stability of higher incomes should be kept in mind. A number of countries with large revenue needs have recently raised tax burdens for higher earners. Much more additional revenue is needed than what can be collected from very high incomes alone, and concerns about economic efficiency and growth must be borne in mind. But historical income trends do signal a significant shift in the relative "tax capacity" from lower to higher-earning groups following steep downturns. In the light of equity considerations and current revenue requirements, there can therefore be a case for progressive tax reforms (*e.g.*, by reducing tax-avoidance opportunities for high-income groups).

Defining an appropriate policy mix of revenue and spending measures

In practice, fiscal consolidation is likely to be achieved through a mix of revenue and spending measures. Appropriately targeted benefit cuts and tax increases can limit adverse distributional consequences. On the tax side, replacing expensive and badly targeted indirect-tax concessions (for food, clothing, etc.) with direct support for low-income households would yield sizeable fiscal gains and reduce inequality. Progressive measures, such as raising ceilings on social security contributions or reducing tax avoidance or evasion among higher-income groups, would also generate revenues while strengthening redistribution.

On the benefit side too, targeted measures help to make fiscal consolidation measures more equitable. Means-testing can reduce benefit expenditures while protecting the most vulnerable. But it can also impose economic costs as it creates work disincentives and can result in low benefit take-up. In the context of fiscal consolidation, an important consideration is the need for adequate administrative and operational resources to enable an effective implementation of targeting measures.

Targeting on *behaviour* (*e.g.*, active job search) or *non-income characteristics* is an alternative that can produce cost savings, while leaving work incentives intact. One example is the use of broad indicators of deprivation, which many countries apply in order to determine eligibility for social housing. These can be a good basis for effective targeting, especially for services and in-kind transfers, without reducing incentives to find employment. Some forms of *conditional cash transfers*, such as those pioneered in Mexico and Brazil, can in fact create *positive* externalities by promoting beneficial health or educational outcomes.

Social policy as an investment in the future

The timing and targeting of fiscal consolidation also has longer-term consequences, even if these are difficult to quantify and often disputed. For some areas of social spending, there is, however, strong evidence of distinct long-term benefits or costs which should inform decisions on how to share savings efforts between different parts of social-protection budgets.

Previous recessions have shown that programmes leading to early withdrawal from the labour market, such as early retirement or disability benefits, create large and practically irreversible increases in social expenditures. These should be avoided at all cost. Other policies have short-term costs but potentially attractive future payoffs. These include active labour market policies, especially for youth, and programmes that help reconcile work and family life. Measures that safeguard child well-being, especially during the formative years of early childhood, are also a high-priority area. Publicly provided services or goods are an integral part of balanced support for vulnerable groups, such as children, job-seekers, individuals with health problems or groups facing extreme economic hardship (*e.g.*, the homeless). Public services can be especially important when elevated poverty rates make access to market-based services difficult for many people.

Strengthening household resilience: Active social policies and the contribution of women

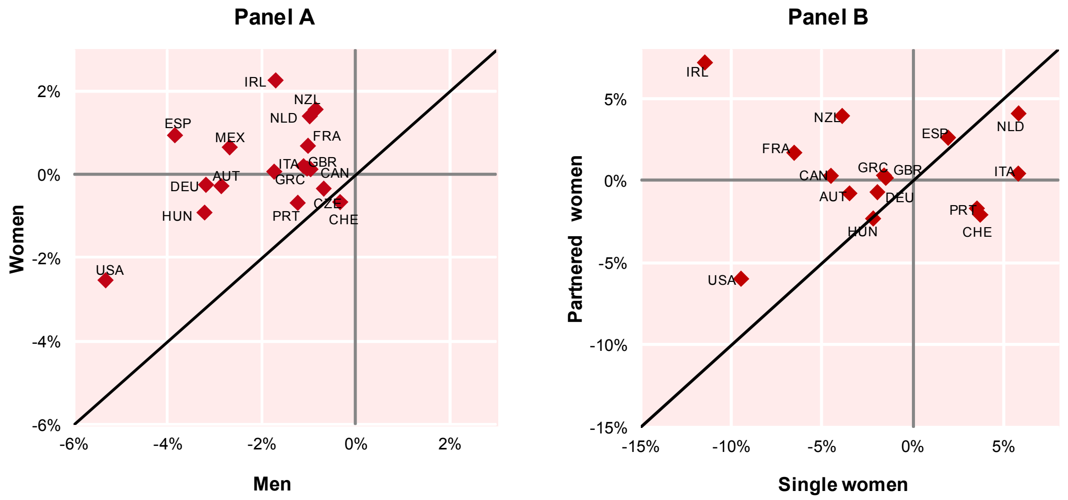
Active social policies are more successful at restoring self-sufficiency if they account as much as possible for the family situation of jobless individuals. But to date, policy responses to the crisis have mostly concentrated on individual job losses. Work-related support should, however, not be restricted to individual job losers, but directed at non-working partners as well.

Female employment has generally suffered much less than that of men in the recent crisis. This is largely due to output losses in sectors with a predominantly male workforce, such as manufacturing and construction. But cuts in public-sector employment announced or already implemented in several countries are likely to change this balance, since female employment is concentrated in the public sector in many countries.

Nevertheless, more women now have current or recent labour market experience than in previous recessions. This has increased their chances of compensating some of their partners' earnings losses, either by finding a job, or by working more. New labour market data show how important female employment is to reduce economic hardship. Job loss and working-hours reductions among partnered men have lowered overall working hours in couple families by between 5.5% in the United States and 0.7% in the Czech Republic (left-hand panel in Figure 2). Working-hours reductions were also sizeable in some of the countries showing little change in unemployment (Austria, Germany). Over the same period, women's working hours have *increased*, or have fallen less than for men. The second panel of Figure 2 shows that partnered women were significantly more likely to work more than singles.

Figure 2. In most countries, women's employment greatly improves families' resilience to economic shocks

Total hours worked by men and women:
Change since onset of crisis



Source: OECD calculations based on tabulations of national labour force data and European Labour Force Surveys.

The degree to which partnered women were able to compensate for their partners' earnings losses varies between countries. Where women already work full-time, working significantly more is not an option. However, many women work part-time, leaving scope for working more even in countries where female employment rates are comparatively high. In a few countries, additional hours worked by women are somewhat greater than reductions in male working hours. But women are, on average, paid significantly less than their partners, so that households will nevertheless tend to suffer earnings losses overall, even if total hours worked are unchanged or even increased.

Policy factors are likely to play a decisive role here. Gender wage gaps are a barrier to female employment. Disincentives created by taxes and out-of-work benefits can also affect work decisions, both for the principal and the second earner in a household. Means-tested unemployment benefits, for example, which are reduced once a partner starts to earn more, can prevent women from working more. Policies that address gender-specific employment and wage gaps tend to strengthen families' resilience to economic shocks, and improve their prospects of benefiting from the recovery.

Issues

1 **How are countries re-balancing tax and transfer policies in order to contribute to an equitable recovery?**

2 **Which areas of social protection and active social policies should be regarded as priority expenditures when making hard choices about cuts in social spending?**

3 **Which policies work best to encourage greater work attachment of all household members and strengthen households' abilities to benefit quickly from the recovery?**

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