WORLD ECONOMIC FORUM

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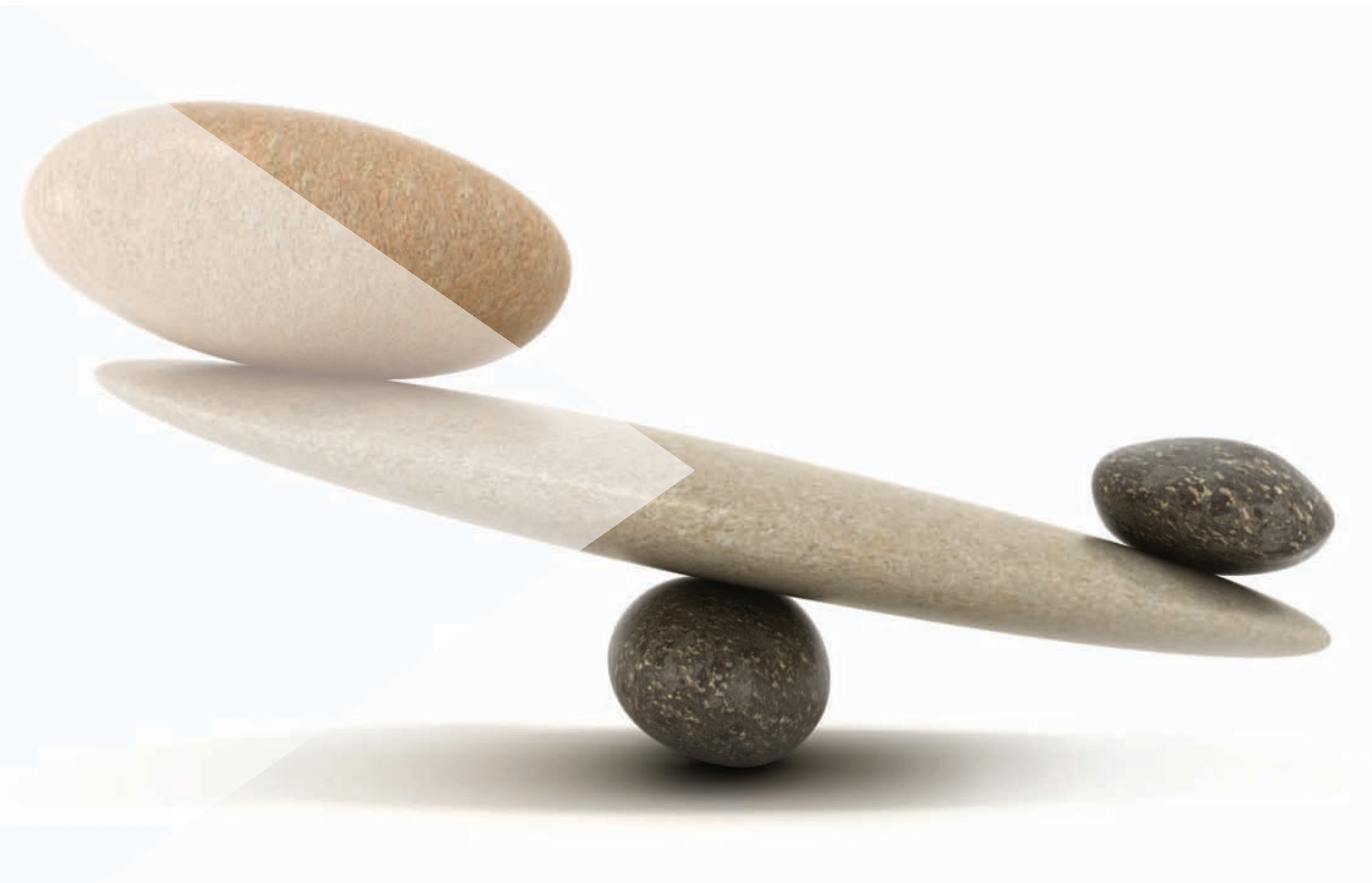
The Case for an Integrated Model of Growth, Employment and Social Protection

Global Agenda Council on Employment and Social Protection



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The views expressed in this report represent a collation of viewpoints emerging from a series of discussions among the Members of the Global Agenda Council on Employment and Social Protection. The observations and proposals in this document do not necessarily reflect the individual institutional viewpoints of any of the companies or institutions that took part, or of the World Economic Forum.

Foreword

As we enter 2012, huge uncertainties characterize economic prospects around the world. In Europe, which is currently at the centre of concern, growth has come to a standstill, even in Germany. In many of the peripheral countries, output is contracting. In the United States, the last quarter of 2011 has seen a slight upturn, but most commentators agree that it remains fragile. In Japan, while there has been some expansion in production after the effects of the Fukushima disaster were overcome, projections remain very cautious.

In many of the emerging and developing countries, growth remains much more rapid, but the problems of the advanced countries are taking their toll worldwide: there seems to be a general slowdown affecting many of the emerging countries also. Strong and sustained growth seems to be eluding the world economy. Moreover, where there is growth, most often it is not accompanied by vigorous job creation

At the time of writing, there appears less consensus on how to move forward than there was in 2008 and 2009. The current Eurozone crisis has brought to the fore wholesale calls for more austerity in Europe in the short run to reduce public deficits and instill "confidence" in financial markets. But positive growth expectations are as important for "confidence" than deficit reduction. Without growth supporting policies, austerity alone is more likely to create a deflationary spiral than a sustainable path to healthier economies and public finances.

The Global Agenda Council on Employment and Social Protection calls for a more growth-oriented and balanced approach – one that fulfills the G20's own Pittsburgh commitment to "put quality jobs at the heart of the recovery". Citizens, not just financial markets, need confidence – confidence for consumers and for firms to invest, and, above all, confidence for our youth so that they can look forward to quality jobs and careers in dynamic economies and just and open societies.

Employment can no longer be treated as a residual outcome of economic growth. Rather, employment growth is now necessary to bring about economic recovery. We also call for recognition that well-designed systems of social protection have acted as important shock absorbers in the crisis and need to be invested in and widened in the future.

From the different backgrounds of business, labour, civil society and academia, we present this "call for action" to move our economies onto a path of recovery and to develop a new social contract in the political economy that emerges from the crisis.

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Executive Summary

This paper is a call to action from the Global Agenda Council on Employment and Social Protection. Central to the argument presented here is the imperative to tackle the global jobs crisis. This must be a top priority for policy-makers despite the current focus on sovereign debt. While the problems in the Eurozone are consuming policy attention today, growth and employment creation, in both the short and long term, are essential if the global economy is to exit from the predicament perplexing policy-makers. This demands a new social contract based on a new economic model, which places equal emphasis on growth, employment and social protection.

Context

The employment challenge is shaped by the wider economic policy context and the risks to a continued recovery. The prospects for the next year look bleak if current policies continue. That is the clear implication of the OECD's Economic Outlook and the IMF's most recent World Economic Outlook. A balance needs to be struck between support for growth and fiscal consolidation. Rapid reductions in public expenditure are not universally desirable when business investment and household consumption are depressed in so many countries.

Addressing the crisis demands effective employment enhancing policy coordination at the global level, including through the G20 and International Monetary Fund (IMF). It is only in this way that policies can be applied without countries finding their credit ratings under threat almost no matter what the underlying budgetary position.

There are three significant challenges confronting policy-makers: stagnating incomes, rising unemployment and increases in income inequality. Consumers need to be confident that their incomes will keep pace with inflation before they will spend; unemployment is a brake on confidence and growth. Income inequality can be a real threat to social cohesion and must be addressed as part of the process of constructing a new model of employment and social protection.

A New Integrated Approach

Growth, employment and social protection should be seen as elements of a virtuous circle where high quality jobs and decent incomes can generate sustainable demand, where there is proper protection against growing labour market risks and where social protection systems are seen to provide a safety net, giving citizens the confidence to consume and businesses to invest. Governments must move quickly to get the global economy moving again. The following measures should be considered:

- Targeted investments in infrastructure
- Public investment in "green jobs"
- Shifting taxation from employment to environmental "bads"
- Targeted tax cuts or increases in cash transfers to low-income households
- Robust minimum wage floors to prevent wage deflation
- Provision of finance for high-growth, small and medium-sized businesses
- Greater progressivity in the tax system
- Higher levels of investment in active labour market programmes
- Creating flexible schemes to promote job retention and job sharing

The Importance of Social Protection

Social protection is relevant to countries at all levels of development. The stabilizing effects of social protection policies can help to minimize the negative impact of recessions in developed countries, maintaining purchasing power and preventing unemployment from being a catastrophic experience. Social protection spending can act as a stimulus mechanism, as well as rebalancing the economies of emerging markets by boosting domestic demand. In the developing world, creating a social protection floor can reduce poverty at the same time as structural transformations are incentivized.

Recommendations

The Global Agenda Council on Employment and Social Protection is calling for the development of a new growth model, which recognizes the importance of employment and social protection. There are five principles that policy-makers should consider as they respond to the crisis and develop a new approach to growth, employment and social protection:

1. A coordinated growth stimulus will be required in 2012 to ensure that employment remains a top priority. This is not to say that all countries can take expansionary fiscal action but, as the OECD has argued, even those with limited room for manoeuvre can slow the pace of deficit reduction if it is part of a careful global strategy.

2. There are priority measures that governments and companies can implement today to boost job creation and retention, such as introducing youth employment pacts or flexible job retention policies equivalent to the short-time working scheme in Germany. Tackling youth unemployment must be a top political priority.

3. Social protection is an important tool for stimulus and growth in the context of the crisis. Reform of social protection systems in many countries may be needed (to take account of demographic change for example), but this is more likely to be successfully achieved when growth has resumed. Reform efforts should proceed and offer maximum choice and flexibility with the involvement of the social partners.

4. In the developing world, the establishment of a social protection floor is essential to reduce poverty and create the conditions for development. Cash transfers to those on low incomes can be designed to be relatively inexpensive, can relieve poverty, boost domestic demand and contribute to the rebalancing of the global economy. By creating a sense of confidence about income security, citizens can be equipped to withstand what might otherwise be intolerably disruptive processes of structural change.

5. In all these cases, governments cannot act alone, but must engage the interest and support of other social actors. This multistakeholder model can help to ensure that change is both legitimized and embedded. Trade unions, business and NGOs have a critical role to play.

Context

Despite the powerful case for decisive action, unemployment is rising in many countries; fiscal consolidation is being pursued with relentless rigour and growth prospects for the global economy are poor. Without jobs, citizens will inevitably struggle to purchase the goods and services needed to keep the global economy moving forward. And, if only insecure work is available, citizens will be more focused on deferring consumption by saving for the bad times than on spending today. In some countries, welfare states are under threat, labour markets are being deregulated and consumer confidence is weak. The pre-crisis economic model has self-evidently failed and the post-crisis policies are failing to deliver their promised results.

The Economic Policy Challenge

Our discussion of the employment challenge is shaped by the wider economic policy context and the risks to a continued recovery. The most recent World Economic Outlook published by the International Monetary Fund (IMF) has downgraded the forecasts for global growth to around 4% in 2012, falling from over 5% in 2010. For advanced economies, growth is expected at what the IMF describes as an "anaemic" 1.5% in 2011 and 2% in 2012. Moreover, these forecasts assume that the policy challenges in the US and the Eurozone are met successfully, with the US striking a better balance between growth-supporting measures and fiscal consolidation, and the Eurozone dealing with the sovereign debt crisis to avoid a catastrophic collapse in the banking sector.

The OECD's recently published Economic Outlook is even more pessimistic, suggesting the possibility of a recession in the Eurozone, the prospect of fiscal tightening in the US (which monetary policy will find it hard to counteract) and softer growth in emerging markets (OECD 2011). The OECD's central projection, which is described as "muddling through", is matched by a number of considerably worse scenarios.

Were there to be a serious relapse into recession, the OECD recommendations are clear – governments must act much as they did in 2009. For example, those countries with considerable room for manoeuvre (Germany, Canada, Australia, South Korea) could administer a significant stimulus. Even countries where public finances are weaker (the US and the United Kingdom) could slow the pace of fiscal consolidation. Brazil, India, China and Indonesia, with comparatively low debt ratios and strong budget positions, would be free to take action to stimulate their own economies.

Of course, there are some countries where the fiscal space is either non-existent or small (Greece, Italy, Spain, Ireland and Portugal). A high level of policy coordination is essential if these countries are to avoid intolerable pain; expanding in growing export markets will require surplus countries to administer the coordinated stimulus that the OECD recommends.

The nature of the macroeconomic policy dilemma can be simply expressed: it is essential at the global level to strike the right balance between support for growth and fiscal consolidation. As the IMF has now recognized, premature fiscal consolidation can limit the possibilities for a robust recovery (Lagarde 2011, Ball, Leigh and Loungani 2011). Policy-makers have to make credible commitments to reduce budget deficits and sovereign debt to stable and prudent levels. But rapid reductions in public expenditure are not universally desirable when business investment and household consumption are depressed in so many countries. Economic policy must be flexible enough to allow governments to change course if an excessive dose of austerity is slowing the speed of the recovery.

The Need for Policy Coordination

An effective response to the crisis demands not just flexibility at the national level, but more international policy coordination. The G20 should develop an agenda for those countries with fiscal room to manoeuvre to implement policies that boost growth. There must be agreement about the pace and scale of fiscal consolidation, a shared understanding of the role of monetary policy and a link to labour market policies. At present, there is a widespread belief that the space for fiscal activism is limited because of the sovereign debt problem; that monetary policy cannot do a great deal more (because once interest rates are close to zero or are negative in real terms a further reduction has little or no stimulatory effect), and quantitative easing is ineffective in countering a balance sheet recession.

Some policy-makers have turned to structural policies, believing that measures to make labour markets more flexible, develop human capital, liberalize product markets, reduce the regulatory burden and tighten competition policy can compensate for the weakness of monetary and fiscal policy. Yet the reality is that structural policies are unlikely to make much difference in the absence of the right macroeconomic policy and in some circumstances could make things worse, especially if the consequence is increased employment insecurity and downward pressure on wages, neither of which are likely to inspire a rise in consumer confidence.

The priority must be to develop an international consensus on a new economic model that delivers the objectives of sustainable growth, high-quality employment and social protection. Despite positive conclusions of the G20 Cannes Summit (on employment, social protection and social dialogue), we saw an almost exclusive emphasis on austerity policies, especially in the Eurozone. If the G20 is to maintain its credibility as the place where decisions are taken and implementation plans agreed, then urgent action is required when the G20 heads of government meet again in Mexico.

We do not underestimate the difficulties of implementing counter-cyclical policies when the burden of sovereign debt is high in some countries and bond markets are nervous. But these observations, far from being arguments against a form of global Keynesianism, reinforce the case for improved coordination. If all countries act together, then the risk of investor flight away from those countries with high debt ratios will be limited and confidence will be much higher if the G20 countries, in particular, all agree on the most appropriate trajectory for policy.

Stagnating Incomes

The remainder of this paper develops some thoughts about the policies needed to strengthen inclusive growth across the global economy. Without growth there can be no effective fiscal consolidation and without confident businesses and consumers there can be no growth. It is essential for most citizens to experience rising real incomes. Unfortunately, real incomes in many countries, particularly in high-income countries, have either been stagnant or have fallen in real terms since 2008. In a recent review, the International Labour Organization (ILO) and the OECD found that nine out of 10 countries under consideration had witnessed real income falls in at least one year since 2008. Over the period 2008-2010, wage growth was weak in France, Germany and the US, and was negative in Spain and the United Kingdom. As the ILO and OECD suggest: *Care is needed to avoid a cycle of wage deflation related to weak growth from further weakening aggregate demand and future growth*. (ILO/OECD 2011)

Unemployment

About 27 million jobs have been lost directly as a result of the recession. In some countries, particularly in the developing world, most recent job growth has been in the informal sector. As we explain in our discussion of the financing of social protection, this is not a sustainable development and action will be needed gradually to formalize informal employment.

While many G20 nations have seen reductions in unemployment over the last year, the poor growth trajectory will certainly slow the pace, leaving unemployment at the end of 2011 close to the peak recorded at the depth of the crisis. The prospects for 2012 look very difficult. According to the ILO, about 80 million new jobs are needed to return global unemployment to the pre-crisis level. This ambitious goal is unlikely to be achieved without some significant policy changes.

Tackling youth unemployment must be the top political priority. Young people (aged 16-24) who lost their jobs first in the recession are finding it difficult to re-enter the labour market during the recovery. Rates of youth unemployment are twice or three times the adult unemployment rate and sometimes more, with the risk that the gap will widen as the recovery slows. Spain has a youth unemployment rate of 45% and South Africa a rate of 50%. Even countries that are doing much better economically have rates of more than 10%; the average across the EU is close to 20%. Youth unemployment has a scarring effect, making it much more likely that a young person will be unemployed later during their working life. It is easy to talk about a lost generation, but unless decisive action is taken now to get the young unemployed back to work that is precisely what many countries in the G20 could experience.

Income Inequality

Decisive action is needed to halt and reverse the rise in income inequality that many countries have witnessed over the last three decades. There are three significant reasons for this.

First, in many countries, income inequality was almost certainly a contributory cause of the crisis. In the US in particular, stagnating real incomes were supplemented by excessive borrowing (not least through mortgages) as a way to maintain or improve living standards. Risk was supposedly diversified through a range of financial derivatives, but when debt defaults began to rise there was real concern about the ultimate value of these instruments, which lead to bank failures and the global recession (Kumhof and Ranciere 2010, Rajan 2010). Reducing income inequality is, therefore, essential if the conditions are to be created for sustainable growth (Berg and Ostry 2011).

Second, social outcomes are better in more equitable societies, most notably health and life expectancy (WHO 2008). A healthier population is likely to be a more productive population, and there will be lower healthcare costs (because prevention is cheaper than cure) and fewer people outside the labour market by reason of ill health and disability.

Third, income inequality, if left unchallenged, can be a real threat to social cohesion, leading to tension between the affluent and those in poverty, and a sense of disaffection and an increase in social bads such as increased rates of incarceration, rising levels of marital breakdown and the entrenchment of social disadvantage (Wilkinson and Pickett 2009).

These arguments have been confirmed by the OECD in their most recent work on the growth of income inequality in the developed world (OECD 2011). The arguments are not purely political or tactical but have a strong economic rationale too. There is a strong business interest in seeing the widespread trend to greater income inequality halted and reversed – businesses need confident, prosperous consumers to buy the goods and services they produce.

A New Integrated Approach

The principal purpose of this document is to make the case that growth, employment and social protection are both interdependent and mutually reinforcing. Without growth, governments cannot tackle the unemployment crisis; without jobs, citizens will be unwilling to consume. If unemployment remains high then businesses will be unwilling to invest.

Growth, employment and social protection must be seen as elements in a virtuous circle where high-quality jobs and decent incomes generate sustainable demand, where there is proper protection against growing labour market risks and where social protection systems are seen to provide a safety net, giving citizens the confidence to consume and businesses to invest. Policy-makers must address the global jobs crisis, halt and reverse the trend towards greater income inequality, and reinvigorate social protection systems so that they are fit to meet the challenge of an integrated global economy and an ageing population.

This paper also aims to show how the case for a new approach to growth is of relevance to countries at all levels of development. Indeed, rebalancing the global economy will prove much easier if emerging market countries (principally the BRICs) boost domestic demand by building their own social protection systems. Developing countries can make progress in relieving poverty, and in boosting productivity and GDP if they make relatively small investments in their social protection floors.

Short-term and Long-term Priorities

As a first step, we should distinguish between short-term and long-term priorities. In the short term, governments must act to get the global economy moving again and tackle the blight of unemployment. In the long term, many governments will have to tackle the challenge of an ageing population, fewer young people entering the labour market, and longer and more flexible working lives. In other words, the demands on the welfare state are likely to increase, and adequate pension provisions will depend on a revived partnership between the state, employers and citizens, with each making a contribution to the savings needed to ensure decent incomes in retirement.

This is not just a problem for developed countries. By 2050, there will be twice as many people in the world over the age of 60 as there are today; 80% of them will be living in developing countries. This demands that social protection systems be reformed, but not abandoned or eroded. A very large number of retired people on very low incomes are not a recipe for prosperity or sustainable growth.

Addressing Short-term Challenges – Getting the Economy Moving Again

We have already noted that the economic outlook for 2012 looks bleak if the current policy mix continues to be administered without any significant change. Both the IMF and OECD have argued that a major shift in policy will be required if the prospects for the world economy deteriorate further. This means that the G20 should give further consideration to a coordinated approach to macroeconomic policy.

Those countries with the space to do so should agree to use all the fiscal policy instruments at their disposal. Other countries, who retain some market confidence, may wish to slow the pace of their fiscal consolidation programmes. Every effort should be made to ensure that those countries with the most severe budget difficulties and the highest debt to GDP ratios can increase the volume of exports as a strategy to restore their economies to health. Specific measures that could be considered are set out below.

Priority measures

1. Ensuring that investment, tax and regulatory frameworks are employment enhancing.

- Targeted investments in infrastructure should be made that will improve the long-term productive potential of the economy and will create the largest number of jobs in the short term. There should be a particular focus on those regions and localities where unemployment is highest with a view to developing targeted strategies, bringing together a range of initiatives (infrastructure, investment in human capital, business investment incentives) to create a comprehensive programme of economic regeneration.

- Public investment in "green jobs" to secure environmentally desirable objectives and leverage private sector investment in environmental technologies. This could include loans or grants for the retrofitting of existing buildings, incentives for "green" construction or a more intensive focus on recycling and resource productivity.

- A serious effort to shift the tax burden from employment to environmental bads so that employers find it attractive to create jobs. This may need to be modified in the future; if the goal is to reduce the incidence of pollution or the level of carbon emissions, then revenues will fall as businesses adopt more environmentally friendly technologies. In the short term, however, reducing payroll taxes could have a beneficial stimulatory effect that would be revenue neutral and employment enhancing if the burden were shifted elsewhere.

2. Creating an environment where economic actors are confident about the future.

- Targeted tax cuts or increases in transfer payments to put more money into the pockets of the low-income households most likely to spend it. In some developed countries, a cut in social security taxes might work well; emerging countries could learn from Brazil's Bolsa Familia, which proved to be a useful instrument for boosting domestic demand at limited cost (26% of the population benefit at a cost of less than 0.5% of GDP).

- Where relevant, the extension of time limits for unemployment insurance payments. This is most relevant in those countries with relatively weak automatic stabilizers such as the US.

- The introduction of minimum wages or other reasonable wage floors where they do not yet exist to offset the risk of a downward spiral of wage deflation.

- Ensure that the banking system is working effectively in providing finance for high-growth, small and medium-sized businesses. Some governments are developing programmes of so-called "credit easing" to improve access to finance. While the precise forms may vary from one country to another, the policy objective is of general application.

3. Implementing job creation and retention policies

- Youth unemployment has a scarring effect, making it much more likely that a young person will be unemployed later during their working life. To avoid the future detrimental impact, the introduction of a youth employment pact is important. Those under the age of 24 who have been unemployed for six months should benefit from a special employment subsidy to be offered to firms willing to employ them for a period of one year, or a full-time funded training place for six months.

- Higher investment in active labour market programmes to improve the skills and employability of the unemployed, particularly for those previously working in industries subject to structural change where demand for such skills is falling.

- Introduction of flexible schemes to prevent job loss, such as the kurzarbeit short-time working scheme in Germany in 2008-09. Public subsidies were available where works councils and employers had negotiated reductions in working time as an instrument to save jobs that might otherwise have been at risk. Workers were compensated by the state for up to 60% of lost earnings, which had the effect of minimizing the impact on their incomes and acted as an automatic stabilizer. Interestingly, "old" policies like the kurzarbeit contributed more to safeguarding jobs in the recession than any of the measures (The Hartz reforms, Agenda 2010) designed to make the German labour market more flexible over the last decade.

Addressing Long-term Challenges – Quality Jobs and Decent Work

Even though employment is the priority, the aim should not be to create jobs at any price but to make clear that sustainable work is decent work. The imperative to develop a new model of growth, employment and social protection is a valuable opportunity to put these questions back on the agenda.

Research from the United Kingdom has shown (Graham 2005) that too many people who have been unemployed find themselves in a revolving door, from poor quality jobs to worklessness to poor quality jobs. The factors that keep the previously unemployed in work include incomes from work offering better living standards than a life on benefits, a working environment that gives people a sense of purpose and meaning, as well as trusting and supportive relationships with the employer.

Epidemiological research shows that high-quality work defined in these terms is also "healthy work". Employees with decent jobs enjoy better health during their working lives, longer life expectancy and more years of active life (Marmot 2004, WHO 2008). One might conclude, therefore, that employers, governments and workers' representatives have a shared interest in trying to create the "decent work" for which the ILO has argued. Businesses stand to benefit because they will have a healthier and more productive workforce. Governments stand to benefit because healthcare costs will be generally lower, releasing resources for other uses. And trade unions benefit because they are working with employers to meet the expectations of employees. Factors that constitute high-quality employment include:

- Employment security
- Allowing workers to exercise autonomy, control the process of work and choose how they organize tasks
- An appropriate balance between the efforts workers make and the rewards they receive
- Procedural justice in the workplace
- Opportunities for workers to influence employer decisions that affect the organization of work and the design of jobs
- The level of trust in the workplace, or what some have described as social capital (Putnam 2000)

Globalization and trade have the potential to raise global welfare, but in the years before the recession, despite rapid growth, the share of workers in the informal economy either remained constant or expanded significantly (ILO/WTO 2009). There is a case for adopting a gradual approach to the formalization of the informal economy, integrating workers into the tax and benefits system at the same time as incomes are boosted through modest transfer to those on low incomes. By using instruments like the Bolsa Familia, the Brazilian government has, over a decade, reversed the ratio of formal to informal employment from 40:60 to 60:40. In the long term, developments of this kind in all countries will enhance fiscal sustainability by increasing tax receipts and providing the resources needed to fund public goods, including a higher level of social protection.

Making progress in addressing the short-term challenges will help policy-makers give proper consideration to the long-term challenges sooner rather than later. It is far from easy to open a discussion about the need for later retirement and longer working lives in the midst of high unemployment and sluggish growth. And if the crisis conditions persist, then the threat to well-established public pension systems cannot be underestimated.

The same might be said of income inequality where a medium-term programme is required to halt and reverse a trend that has been established in some countries for more than 30 years. Devising more progressive tax systems, boosting the incomes of those at the bottom of the distribution scale and restraining excess at the top cannot be completed in the space of a year. Gradual improvements in minimum wages, a programme of investment in human capital and an agenda to reduce the reliance of some organizations on low pay, low-productivity business models is an ambitious project.

This is equally true to re-establish the link between wage growth and productivity growth in those countries where it has been broken. Some commentators have suggested that the bargaining power of employees on wages at and below the median must be improved (Kumhof and Ranciere 2010). This is a significant challenge too because it requires strong and responsible labour market institutions (trade unions and other actors) to ensure a fairer initial distribution of market incomes.

The Importance of Social Protection

Social protection policies played a critical role in mitigating the impact of the global financial crisis in 2008 and 2009. This was certainly true in those countries with stronger welfare states and where the automatic stabilizers (the payment of relatively generous benefits to the unemployed and the willingness to maintain public spending despite falling tax revenues) had the effect of supporting purchasing power. Sustaining these policies is essential for the development of a new model of growth.

Slightly different arguments apply to developed economies, emerging markets and the developing world, but in each case social protection has a critical role to play. For these purposes, the extent of social protection is defined in relation to the following areas of social policy:

- Pensions
- Unemployment benefits
- Health and sanitation
- Housing
- Child and maternity protection
- Education for all

Countries with higher levels of social expenditure have lower levels of poverty and income inequality. This appears to be a universal truth for countries at all stages of development. We should recall that in the process of becoming the prosperous societies they are today, developed countries witnessed an increasing share of national output being devoted to public expenditure funding collective consumption (Lindert 2004). Indeed, rising social spending contributed to economic growth.

It is also clear that the existence of a social protection floor reduces poverty and inequality in all countries. For example, the OECD estimates that levels of poverty in its member countries are about half of what they would be in the absence of such policies and institutions. The results are similar for middle and low-income countries – studies in Senegal and Tanzania demonstrate that "modest cash transfer programmes for older people and children have the potential to close the poverty gap significantly" (Bachelet 2011).

Why Social Protection Matters

The case for social protection rests on four pillars:

1. Social protection can act as an economic stabilizer during a crisis
2. Social protection can kick-start demand as part of a stimulus package to speed up the exit from the crisis
3. Social protection can be used to boost domestic demand and reduce reliance on export-led growth in emerging economies
4. The establishment of a social protection floor can accelerate the pace of development in developing countries

Stabilizing: The stabilizing effects of social protection policies are generally accepted as important in maintaining purchasing power during a downturn, and, if governments allow deficits to rise as tax receipts fall, are important foundations on which a future recovery can be built. Indeed, a significant difference between the immediate response to the post-1929 Depression and policy today is that the importance of automatic stabilizers is widely understood. The difficulty, of course, is that some countries, particularly those with profound sovereign debt problems or rapid fiscal consolidation programmes, are cutting benefits for the unemployed and other forms of social support at a time when incomes are under pressure and demand is weak.

Stimulating: Increased spending on social protection was a central element in the fiscal stimulus programmes implemented in the wake of the crisis. For example, in Brazil, the *Bolsa Familia* and unemployment insurance benefits were raised, injecting some US$ 30 billion into the Brazilian economy, saving or creating around 1.3 million jobs. In the US, the Congressional Budget Office estimated that the extension of unemployment insurance and other social transfers had a bigger multiplier effect than reductions in taxes for the better off or incentives for first-time homebuyers. In Indonesia, 7% of the stimulus package was directed towards low-income households, with an overall increase of 34% on social protection spending in 2009. The results were impressive: an increase in spending on children's education and health needs; an increase in immunization rates; improved infrastructure leading to more rapid economic development; improvements in water quality, transport and productivity; and reductions in the cost of living, moderating the impact of food shortages or price increases (Bachelet 2011).

Rebalancing: Emerging market countries can use social protection to adapt their economic models and move towards a path that attaches importance to domestic markets and exports. One consequence of the Asian crisis in 1997 was that countries began to build up significant levels of foreign exchange reserves to insure against the risk that rapid disinvestment could have a catastrophic and immediate impact on the stability of the banking system. At the same time, and often as a result of relatively weak social protection, households were required to save to insure themselves against the risk of ill health, old age and unemployment. These two phenomena helped to create some of the imbalances in the global economy – surpluses in Asia, large deficits in the US and to a lesser extent the United Kingdom – that both caused and intensified the financial and economic crisis in 2007-2008. Boosting domestic demand by expanding social protection is now at the heart of economic policy in China.

Developing: It is sometimes said that social protection is a luxury that developing countries cannot afford. But as the Bachelet report points out, relatively small investments can have big social effects: reducing poverty, encouraging entrepreneurship, boosting school attendance and improving nutrition. Creating a social protection floor is not just a consequence of development but part of the process of development.

Relevant to Countries at All Levels of Development

For *developed* countries, social protection allows the risks experienced by most citizens to be managed effectively. It ensures that disruptive processes of social and economic change have less than devastating effects on those most at risk, it legitimizes the operation of markets, which otherwise might be subject to fundamental challenge, and it ensures, at least in principle, that all citizens can develop the capabilities they need to choose lives that they value (Sen 2009).

Well-developed healthcare systems, decent pensions and the extensive provision of education services are all taken for granted by electorates in the most successful northern European countries. Elsewhere, it is sometimes said that these services are unaffordable or a burden on business or a threat to competitiveness, but in reality the dynamism of most successful economies has been due to a symbiotic relationship between markets and public services. Businesses need healthy, well-educated, committed workforces with an appetite for change and innovation. Dismantling the edifice of social protection developed over a century or more of social policy would be as much of a threat to enterprise as to the social cohesion of developed economies.

For *emerging markets*, social protection can, as we have seen, play an important role in rebalancing an economy – from a focus on export led growth to the development of domestic demand. China's 12th Five-Year Plan is deliberately designed to restructure the economy in this way. Among the pro-consumption initiatives are incentives for the development of labour-intensive sectors and wage increases alongside measures to widen the coverage of pensions, healthcare and unemployment protection. All of these policies build on the successful Minimum Living Standards Scheme, which had 22 million beneficiaries in 2002 and was a response to the unemployment generated by the restructuring of state owned enterprises, initially in urban areas and then in rural communities.

For *developing countries*, social protection obviously reduces social risks, but can also contribute to productivity and growth. Mauritius managed the transition from a monocrop economy to a high-growth economy with the lowest poverty rates in Africa partly because the provision of a social pension made it possible to legitimize this radical reform. In Mozambique, recipients of a food subsidy programme use the money as working capital for small-scale trade. In Kenya, a food-for-work programme resulted in a 52% increase in net farm incomes with increased levels of capital investment. Moreover, the poverty reduction results are impressive. In Ethiopia, a public works and unconditional cash transfer programme reached 8 million people, increased livestock holdings by 14% and guaranteed 30% more food to beneficiaries in drought affected areas. In Kenya, the Orphans and Vulnerable Children Programme resulted in a 15% increase in school enrolments for primary schools. As in the developed world, there can be no doubt that these interventions are equipping citizens with the capabilities they need to choose lives that they value.

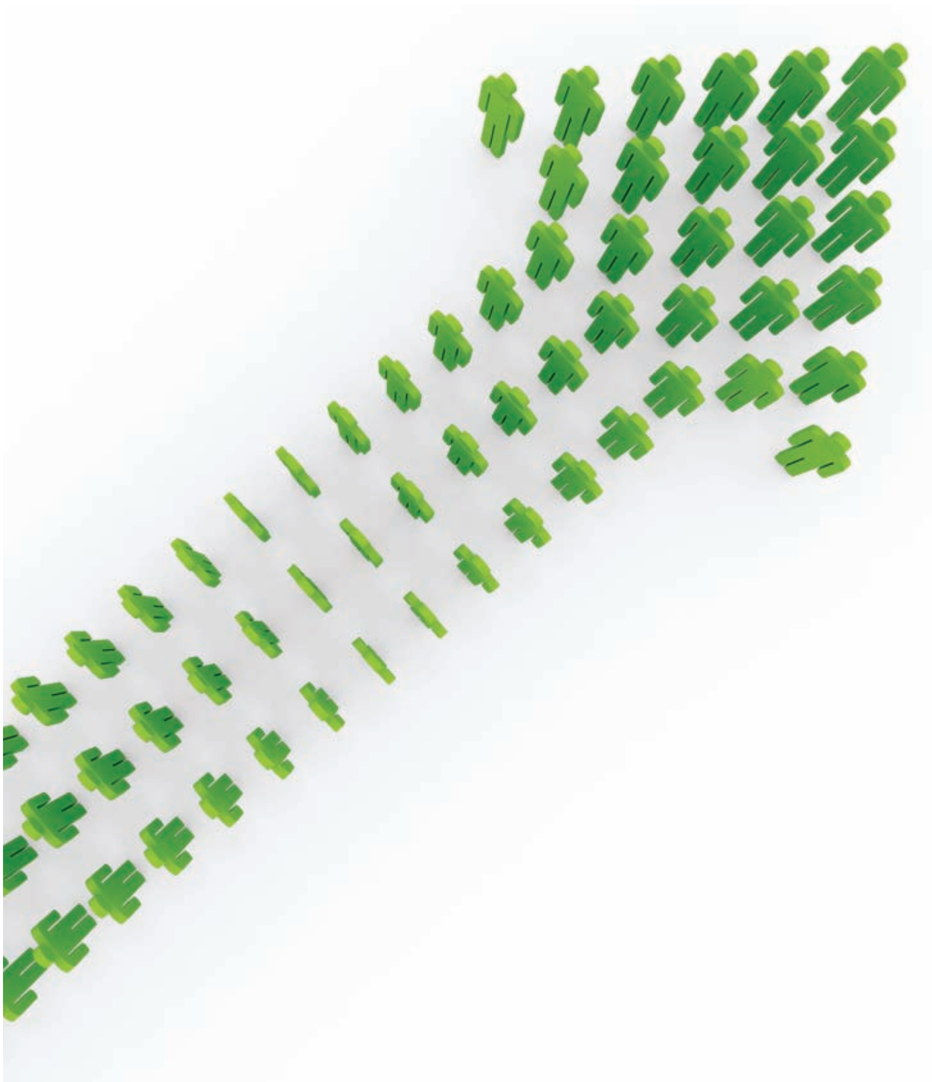
Financing Social Protection

Sluggish growth and the possibility of another global recession will raise serious questions about the funding and affordability of well-developed social protection systems. There are voices in developed countries that demand the reform of pensions systems, public services and labour markets on the grounds that these arrangements are simply unsustainable in a more competitive world. Reform may be needed to take account of demographic change, but this is more likely to be successfully achieved when growth has resumed.
So far as pensions are concerned, the critical questions include:

- To what extent do retirement ages need to rise and by how much?
- What additional contributions might be required?
- Who will pay and how much will they pay?
- How will this very different labour market be managed and who will be responsible for developing good practice in managing an older workforce?

In developed countries, similar questions apply to healthcare, education and public services more generally. It is clear from the Nordic experience, however, that the development of a comprehensive welfare state is no obstacle to good economic performance. By way of contrast, the recent performance of the US suggests that a relatively underdeveloped social protection floor is a cause of weakness and instability rather than strength (Rajan 2010). In other words, it is not that welfare states are unaffordable but a question of who pays and how much.

Where social protection systems need to be reformed, governments have a choice. They can either impose change or they can negotiate change with the relevant stakeholders. Building consensus with social partners may be slower, but is a more certain way to a durable solution.



Developed Countries
The diversity of systems should be recognized; developed countries have taxpayer-funded provisions, insurance-based systems and sometimes wholly private sector arrangements (as with the US healthcare system with the exception of provision for the elderly and those living in poverty). Prescribing an ideal set of financing arrangements for the developed world would not be helpful in moving this discussion forward, although there are some fundamental principles of adequacy and effectiveness that might be derived from the experience of OECD countries.

It would also be wise to recognize that a partnership between the state, business and citizens is often the foundation on which robust financing arrangements have been built. In some countries, this is already the case with the pensions system where state provision is supported by private arrangements based on contributions from workers and their employers. Similar arrangements might be considered for the education system. For example, employers could sponsor students and fund tuition fees. Alternatively, policy-makers might encourage the development of savings schemes that could be used to fund the costs of education, childcare and care for the elderly.

Even if these possibilities are realized in practice, the core of the social protection system (state pensions, primary and secondary education, out of work benefits) is likely to remain principally tax funded with contributions from individuals and corporations. Once again, though, there will be variations across countries in the generosity of support available depending on the tolerance of electorates for progressive taxation systems with relatively high marginal rates. This is essentially a matter of social and political choice. It is unlikely that the US will experience Swedish rates of taxation in the near future or that a radical tax-cutting agenda would survive a confrontation with the Swedish electorate. In other words, so far as the developed world is concerned, the mix will vary from one country to another as a result of culture, history and political preference.

Developing Countries
For the developing world, the questions are rather different. How can low-income countries find the fiscal space to develop a social protection floor? As the Bachelet report explains, the costs of developing a basic social protection package would be between 2.2% and 5.7% of GDP (Bachelet 2011). A universal pension for individuals over the age of 70 could be as little as between 0.2 % and 0.8% of GDP in low-income countries surveyed (Knox-Vydamov 2011). The relatively small sums involved may provoke some surprise that more countries have not made progress.

The barriers to implementation may be high but are not insurmountable. What more might developing countries do? To begin with, social protection requires sustainable and long-term financing and some developing countries have found it difficult to make this commitment. Most importantly, perhaps, low and middle-income countries face a variety of challenges in broadening their tax base. The causes might be located in the high level of informality in labour markets and weak institutional capacity. It is very hard to collect taxes (whether income taxes or payroll taxes) if employers and employees operate beyond the margins of legality. The phased formalization of employment would help, but in the meantime developing countries should look elsewhere for resources. Possible options might include tariffs on commodity exports, land and property taxes, urban property taxes and agricultural marketing boards (Di John 2011).

Besides these options, governments themselves could use increased funding and coordination from donor countries. For example, the Bachelet report recommends the following:

- Predictable multi-year support for the strengthening of nationally-defined social protection floors in low-income countries
- Cooperation between OECD donors and emerging donors like the BRIC countries to build predictable funding through direct budgetary support, as well as building on the direct experience of the emerging market countries in building their own social protection systems
- Development of innovative financing mechanisms such as the financial transactions tax or the carbon tax on international shipping recommended in the Innovation with Impact: Financing 21st Century Development report presented by Bill Gates to the G20 in November 2011; the report also recommended that developing countries could improve their systems for raising taxes from extractive industries including oil, gas and mining.

Case Studies: The Integrated Model in Practice

In this section we present a series of country case studies that demonstrate how different elements of the model described so far have already influenced the development of policy:

Inclusive Growth

- How Sweden moved from being a poor and largely agricultural economy to a country with a very high standard of social protection.
- Employment measures: The short-time working scheme in Germany is an example of how the state can support action by employers and employees to minimize the risks to employment during a downturn. It shows that preserving jobs is often more economically rational than allowing jobs to disappear. It also demonstrates the importance of creating incentives for dialogue between the social partners so that cooperation rather than confrontation is the immediate response to a crisis.
- Youth pacts: A number of countries have introduced support schemes to ensure young people are in a job or vocational training, such as Germany's dual vocational training system.

Social Protection

- South Africa and Brazil have taken steps on the same path as Sweden and have seen big improvements in social outcomes.
- The Mexican case studies demonstrate that governments can proceed on a broad front simultaneously, with changes to labour market and health policy, both of which have produced beneficial economic outcomes.

Sweden: Social Protection a Precursor to Economic Growth and Development

Sweden was comparable to many low-income countries at the outset of its welfare development, but now ranks in the top five countries in the World Economic Forum's *Global Competitiveness Report*. There are parallels between the socioeconomic context of Sweden at the outset of implementing social protection with low-income countries today. Towards the end of the 19th century, Sweden had a per capita income comparable to that of Cambodia and Tajikistan today.

The development of extensive social protection was core to transforming Sweden from one of the poorest European countries to one of the most prosperous. When Sweden began implementing social security it was one of the poorest European countries. At the end of the 19th century, Sweden took the lead alongside a handful of other European countries to broaden social spending on the back of industrialization of natural resource sectors. Urbanization and changing household structures increased the need for more suitable social protection. After increasing investments in education, in 1913 Sweden guaranteed a state pension to all men and women over the age of 67, which was followed by employment benefits for the sick and disabled.

By 1917, Sweden developed a universal health care system, and by 1930 was spending more than 2% of GDP on social transfers. It is important to note that investment in the health system and pensions were precursors to economic development in Sweden and as such contributed to economic growth. Over the last 10 years, Sweden has achieved an economic growth rate that exceeded the European average, with lower than average unemployment.

The Swedish social protection system is built on the principles of equal rights to education, health care and social insurance, with the state taking on primary financial responsibility. Sweden spends 12.6% of GDP (2007) on cash benefits.

Kurzarbeit – The German Short-time Working Scheme

The *kurzarbeitergeld* (short-time working compensation programme) is administered by the German public employment service. Since January 2009, the programme has been redesigned to take account of the severity of the global financial crisis.

- To be eligible for the programme, companies simply have to show that the affected employees have suffered a reduction in wages of more than 10% (employers have to show that one-third of employees have been affected).
- The eligibility period has been extended from 18 to 24 months (having initially been extended from 12 to 18 months when the crisis just began to take hold).
- Extra financial support has been introduced to offer incentives to organizations that offered employees training opportunities if the short-time working scheme is being used.
- The government covers half of the employer's social insurance contributions and all of their associated contributions relating to the payment of short-time work allowances after six months of the programme, or all of their associated contributions from the beginning of the claim if the employer offered the workforce the required training opportunities.

Consistent with our general argument about stakeholder engagement as an ingredient of crisis response policies, German workers have strong institutional guarantees that negotiated hours and earnings reductions will be open, transparent and fair. The universal coverage of collective bargaining, combined with effective workplace representation through work councils, helps to ensure that workers are participants in these processes.

As the German Ministry of Labour has pointed out, the scheme makes financial sense because the costs of the short-time work allowances are generally lower than unemployment benefits. Moreover, if the training option is used, the German economy will benefit from an improvement in human capital, ensuring that the employer can respond well to the economic recovery when it materializes.

There are no restrictions imposed on the programme – all companies in all sectors are eligible. As we have noted, if the employer has a work council, then the hours and pay reductions must be agreed with the workers' representatives. If not, then each of the affected employees must consent to the arrangement. At that point the employer can make an application to the regional unemployment service to ensure that:

- At least one employee has suffered a reduction in wages of at least 10% as a result of a fall in demand caused by the current economic conditions
- It is reasonable to assume that the situation will improve in 24 months, allowing for the reinstatement of normal weekly working hours
- All other options for managing the reduction in demand have been exhausted.

This last condition is more than a formality. The employer must be able to offer evidence that they have considered and implemented other courses of action, an important limitation preventing abuse of the scheme.

If the employer's application is accepted, the federal authorities (essentially the employment service) compensate the employees for the sacrifice of wages at the level of 60% of lost net earnings for employees with no children and 67% for those employees with children. The reimbursement of employer social security contributions is another incentive to agree reductions in hours and earnings.
The German scheme is not unique and analogous arrangements can be found in 11 other EU member states and Norway. Some of these schemes offer incentives for skills development; others do not.

Germany and Australia: Youth Pacts

The Dual Vocational Training System in Germany is recognized as a contributor to falling youth unemployment rates. The in-company training component of dual vocational training courses provides students with first-class professional qualifications, ensures that a high percentage of trainees find employment in the labour market and helps to reduce youth unemployment. There are currently about 1.6 million young people undertaking dual vocational training in Germany.

Students who successfully complete such a course have the skills needed for a profession as a skilled worker in one of approximately 345 occupations requiring formal training. The system is called "dual" because training takes place in two learning institutions: a company and a vocational training college. The scheme aims to train students to do a specific job. After finishing their vocational training, the trained skilled workers have the requisite qualifications needed to perform a specific occupation.
The system is based on an equal partnership between the public (government, schools) and private sectors. Many other countries are now looking to introduce systems similar to the dual training system, with the aim of reducing youth unemployment and strengthening the link between education and employment systems (training and labour market).

In Australia, 10% of 15-24 year olds are not in school, training or employment. In 2009, the Australian government introduced its Compact with Young Australians, known as the "Earn or Learn" initiative. The Compact is designed to ensure that all Australians under 25 are working, studying or training, or some combination of these, with eligibility for relevant youth allowance payments being tied to participation requirements.

As part of the Compact, there is a guaranteed entitlement for those aged 15-24 to an education or training place for any government-subsidized qualification, subject to admission requirements and course availability. For those aged 20-24, the entitlement is for a qualification higher than any current qualification they hold.

The government also introduced the Apprentice Kickstart scheme to address falling apprenticeship commencements in 2009, tripling the commencement bonus for employers taking on apprentices from US$ 1,500 to US$ 4,850.

Group training is an innovative feature of the Australian apprenticeship system whereby a single group training company takes on the responsibility of employing the apprentice and sourcing the host employers. It is a mechanism for sharing the risk of employing an apprentice, and means that apprentices' employment security is not tied to a single employer. It also gives apprentices access to different on-the-job experiences.

Social Protection in South Africa and Brazil: Common Elements of Success

South Africa and Brazil are both leaders in providing extensive, near-universal social protection floors. Both disburse cash transfers to about 25% of the population, as well as providing social and welfare services. In both countries, social protection has achieved substantial social and economic impacts. There are a number of significant parallels in the political drivers for social protection.

Primary Targets/Recipients

South Africa and Brazil identified children and older people as primary targets of social protection, both in terms of numbers of recipients and being the first groups to benefit from social protection programmes. The tables below outline the largest cash transfer programmes of both countries, among which social pensions and children grants receive significant budgetary commitment of between 2-3.5% of GDP.

Table 1 – Largest Cash Transfer Programmes: South Africa

Programme	Target Group	Coverage	Spending
Old age grant	Men and women age 60+	2.6 million	US$ 5 billion
War veterans grant	War veterans	0.001 million	US$ 2 million
Disability grant	Disabled adults unable to work	1.3 million	US$ 2.5 billion
Child support grant	Children age 1-16 from poor households	10 million	US$ 4.5 billion
Care dependency grant	disabled children age 1-18 payable to parents/ *caregivers*	0.4 million	US$ 234 million
Foster care grant	Foster parents	0.5 million	US$ 723 million
Social relief of distress	Temporary hardship/emergency benefit for those ineligible for above		US$ 21 million
Total	All non-contributory cash grants	14 million	3.5% of GDP, or approximately 12% of total government spending

Source: Data from National Budget 2011, Treasury of South Africa, see http://www.treasury.gov.za/documents/national%20budget/2011/review/chapter%207.pdf using US$ conversion rates on 3 August 2011.

Table 2 – Largest Cash Transfer Programmes: Brazil

Programme	Target Group	Coverage	Spending
Bolsa Familia	Poor households with school age children	12.4 million families	US$ 7.7 billion, 0.4% of GDP
Rural Pension – Previdencia Rural	Older workers from the informal (rural) sector	7.9 million pensions	0.8% GDP
Continuous Cash Benefit – BPC: Beneficio de Prestacao Continuada	Older people in poverty and disabled people	3.2 million beneficiaries	US$ 12 billion, 0.6% GDP

Source: *Data from pension-watch database* www.pension-watch.net *and Paes-Sousa et al (2011)*

Substantial Social and Economic Impacts

Widespread evidence of developmental impacts of social protection in both countries, including:

- Reduced poverty and inequality: In South Africa, child poverty without child support grant would be almost 50%; in Brazil, 30% of the reduction in inequality between 2001-2004 has been attributed to social pensions and 20% of the reduction in equality between 1995-2004 to the Bolsa Familia programme.
- Increased school attendance: In South Africa, pension led to an 8% increase in enrolment among the poorest 20%; similar impacts on school enrolments reported in Brazil.
- Economic stimulus: Through the injection of cash to economically marginalized regions sectors of the population, economic stimulus has spurred knock-on impacts on consumption and maintained domestic demand in Brazil, and promoted job searching and labour market participation in South Africa.

Programme of Temporary Employment in Mexico (PET)

PET grants temporary income for men and women aged 16 or older in periods of low labour demand through participation in family or community projects in the areas of health, education, conservation of cultural and archaeological sites, and building rural roads. The budget for this existing programme was increased by 64% in 2009 to help alleviate workers and families during the crisis, and its coverage was extended to include urban areas in addition to the rural areas previously covered. The amount of time spent in such work depends on the type of project and must not exceed 132 working days per year.

Since 2008, the National Employment Service (SNE) has operated emergency programmes designed to address the needs of people in employment contingencies due to economic and/or social difficulties. To meet the needs of the Mexican population, the SNE has diversified, positioning itself as an instrument of dynamic employment policy, able to adapt to labour market demands and respond effectively and in a timely manner. The SNE expanded its coverage and refocused its attention to address not only the unemployed and underemployed, but to include workers who are at risk of losing their jobs or whose income has been affected.

New programmes added in 2009 led to the following: 5,078 people were employed in temporary compensation schemes; 37,819 people were linked into the SNE Temporary Employment Programme; and 66,555 people were able to keep their jobs or income through the training of temporarily laid-off workers and programmes to support employment and the tourism sector.

Recommendations

The objective of this paper has been to make the case for a new approach to growth, emphasizing the importance of employment and social protection. Recognizing these interdependencies represents a departure from the pre-crisis paradigm, where social protection is no longer seen as a cost to the economy but as a source of resilience in tough times and as a support for growth and productivity when times are good.

It would be easy to argue that the measures proposed in this paper are limited in applicability to times of prosperity, but are unaffordable when the global economy is growing slowly. Our response, however, is that without growth all other economic policy objectives will remain elusive. The core of the argument presented here is that action is needed to develop the integrated model of growth, employment and social protection if the world economy is to be restored to health.

A theme running through this paper is that governments are more likely to make progress when they have the support of other actors, including business, trade unions and NGOs. This is not to say that all countries will adopt the same approaches. Institutions are very different and the capacities of the parties will vary enormously. What we can be certain of is that inclusive approaches, however defined, are more likely to be effective.

A Five-Point Plan for Growth, Employment and Social Protection

We recommend that policy-makers develop policies consistent with the following principles:

1. A coordinated growth stimulus will be required in 2012 to ensure that employment remains a top priority. This is not to say that all countries can take expansionary fiscal action but, as the OECD has argued, even those with limited room for manoeuvre can slow the pace of deficit reduction if it is part of a careful global strategy.

2. There are immediate measures that governments and companies can implement today to boost job creation and retention, such as introducing youth employment pacts or flexible job retention policies equivalent to the short-time working scheme in Germany. Tackling youth unemployment must be a top political priority.

3. Social protection is an important tool for stimulus and growth in the context of the crisis. Reform of social protection systems in many countries may be needed (to take account of demographic change for example), but this is more likely to be successfully achieved when growth has resumed. Reform efforts should proceed and offer maximum choice and flexibility with the involvement of the social partners.

4. In the developing world, the establishment of a social protection floor is essential to reduce poverty and create the conditions for development. Cash transfers to those on low incomes can be designed to be relatively inexpensive, can relieve poverty, boost domestic demand and contribute to the rebalancing of the global economy. By creating a sense of confidence about income security, citizens can be equipped with to withstand what might otherwise be intolerably disruptive processes of structural change.

5. In all these cases, governments cannot act alone but must engage the interest and support of other social actors. This multistakeholder model can help to ensure that change is both legitimized and embedded. Trade unions, business and NGOs have a critical role to play.

In this paper, we have outlined an extensive menu of policy options that exemplify these principles. We urge policy-makers to not only consider this approach in principle, but recognize that practical action must be taken as soon as possible. The next G20 summit in Mexico City is an invaluable opportunity. The world cannot wait long for a solution to the deepest global crisis in several generations. The time for action is now.

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