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Social Policies for a Recovery

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ABSTRACT

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The fallout from the global economic downturn of 2008-09 is a continuing source of stress on families and a constraint on government policies. How can social policies contribute to a quick and equitable recovery from the crisis and how can they best respond to the difficulties that households continue to face? What role can and should social policy budgets play in improving the budget outlook of countries facing unsustainable government debt? And how should governments prioritise different areas of social spending when faced with heightened demand for support but, often, much reduced fiscal space? This paper addresses these questions in light of countries' experiences during the most recent and earlier economic downturns.

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SOCIAL POLICIES FOR A RECOVERY

Herwig Immervoll and Ana Llena-Nozal[1]

The fallout from the global economic downturn of 2008-09 is a continuing source of stress on families and a constraint on government policies. Due in part to effective, but expensive, automatic stabilisers and discretionary fiscal stimulus, growth in economic output has now resumed in most OECD countries and has further accelerated in major emerging economies. Much uncertainty remains, however, and the recovery so far has been partial and highly uneven. Labour markets in most countries remain slack, household wealth has been eroded and commodity prices are volatile. These factors can inhibit families' attempts to contain the damaging effects of economic woes on their current and future well-being.

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, active social policies remain highly relevant: they can help deliver a sustained, job-rich and equitable recovery.

But social-protection systems are under pressure. The economic crisis and slow recovery have added further urgency to meeting the demographic and structural challenges facing welfare states. Furthermore, the majority of governments are embarking on fiscal consolidation. Social expenditures, which account for about half of total public spending in OECD countries, cannot be exempted from savings efforts. But this is difficult in the context of elevated need for government support and there will be consequences for poverty and inequality.

How can social policies contribute to a quick and equitable recovery from the crisis and how can they best respond to the difficulties that households continue to face? What role can and should social policy budgets play in improving the budget outlook of countries facing unsustainable government debt? And how should governments prioritise different areas of social spending when faced with heightened demand for support but, often, much reduced fiscal space? This paper addresses these questions in light of countries' experiences during the most recent and earlier economic downturns.

The first part sets out the current fiscal context for social policy making. The second part considers the distributional consequences of economic downturns and discusses the equity implications of different social policy responses, notably of tax and transfer policies. The third part highlights the role of employment growth for tackling both fiscal challenges and concerns over rising inequality. The fourth part analyses countries' recent and announced policy initiatives and compares current trends in social expenditure with the patterns seen over previous business cycles. A final part concludes by discussing policy priorities for helping households, and government budgets, recover.

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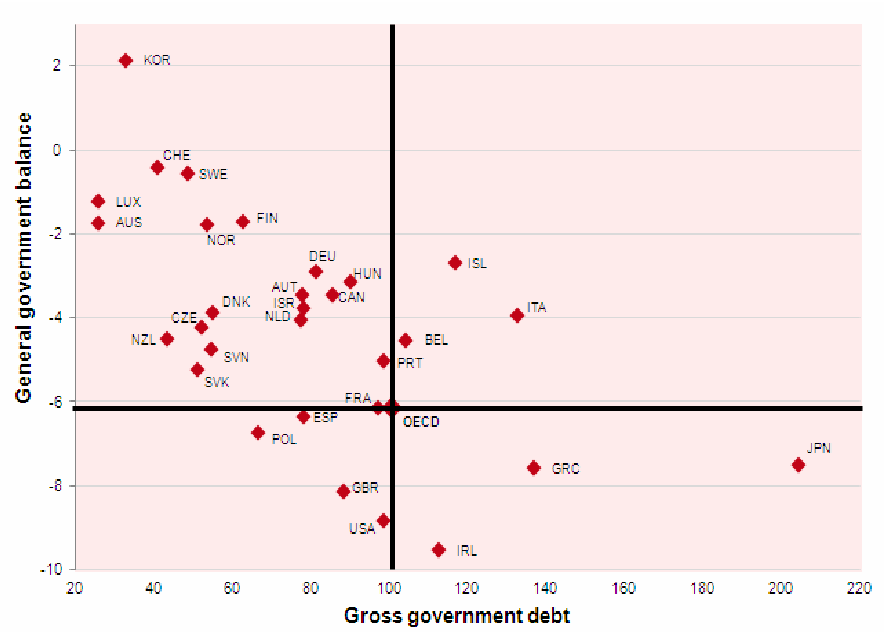
1. An earlier version of this paper has served as background paper for discussions at a meeting of OECD Social Policy Ministers in May 2011. The discussion draws on the most current data and projections at the time of writing. The paper has been prepared by Herwig Immervoll who, at the time of writing was senior economist at the OECD Social Policy Division and is currently senior economist at the World Bank, and by Ana Llena-Nozal, economist at the OECD Social Policy Division. We are indebted to numerous colleagues at the OECD for very helpful comments on earlier drafts. The usual disclaimer applies. In particular, the views expressed do not represent the official positions of the OECD or the governments of its member countries.

1. 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 (Figure 1). The total deficit in OECD countries is expected to exceed 6% of GDP in 2011, with France, Greece, Ireland, Japan, Poland, Spain, the United Kingdom and the United States, having the largest shortfalls.[2] Some countries with high deficits face less intense market pressure than others to close budget gaps, and the shortfalls expected for 2011 are a significant improvement over 2010. But the levels of borrowing are still historically very high. Total gross government debt in 2011 in the OECD as a whole will reach 100% of GDP. In Greece, Italy and Iceland, debt levels are significantly higher, while Japan's government debt is expected to exceed 200% of GDP. At the other end of the spectrum, deficits are likely to be 3% or less of GDP in around a third of countries. Debt-to-GDP ratios below 60% are also projected for around a third of countries.

Figure 1. Government debt and balances

Forecast for 2011, per cent of GDP



Note: Financial balances include one-off factors and are on a national accounts basis. Both deficits and debt levels may differ from the numbers reported to the European Commission for some EU countries. Data for Norway are for mainland Norway only, excluding net revenues from petroleum activities.

Source: OECD (2010), Economic Outlook, No. 88. See www.oecd.org/eco/sources-and-methods.

Compared with OECD economies, the public finances of major emerging economies are in better shape. Growth in output and government revenues continued during 2007-09, although public expenditure increased more rapidly than revenues. In emerging G20 economies, budget deficits were held under 4% of GDP in 2010, half the level in the OECD for that year. In some emerging economies, such as India, deficits are much bigger, but are not unsustainable as long as economic growth remains high.

2. These projections were based on policy announcements up to November 2010. They do not include, for instance, the December 2010 agreement in the United States to extend tax cuts.

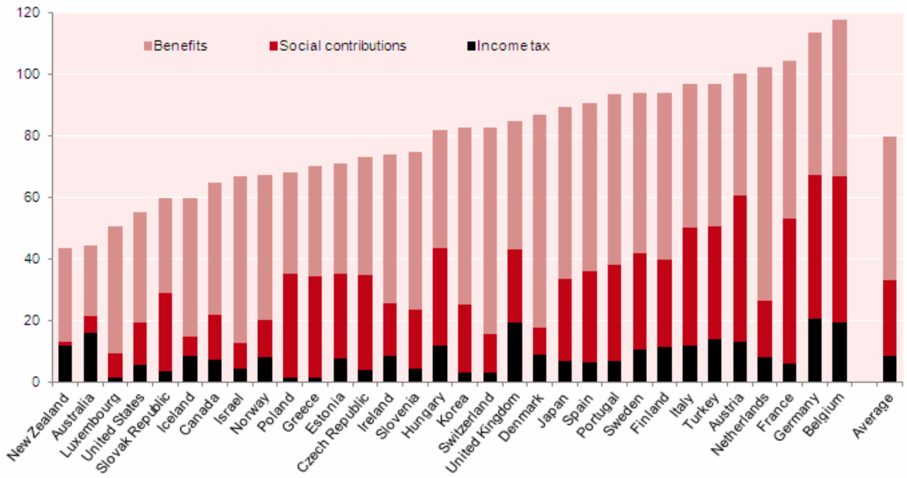
The need for and urgency of short-term fiscal consolidation therefore varies. Importantly, however, the greater part of current deficits is believed to be "structural" rather than "cyclical" in a number of OECD countries.[3] This means that governments in these countries will still be spending more than they receive in revenues when the recovery is well entrenched. To address structural challenges, all countries need to seek ways to maximise the value for money that their social protection systems provide.

1.1. The wider costs of unemployment

Unemployment is costly – for the individuals concerned and for the economy as a whole. The immediate budgetary loss due to higher benefits and reduced revenues (from income taxes and social security contributions) can be in the order of 80% of GDP per head for a lost full-time job. Figure 2 illustrates these costs for low-to-average earners entitled to unemployment benefits. The immediate fiscal effects of job loss can be smaller for some groups, such as those with very low earnings (and so a small direct-tax burden) or those entitled to little or no benefits. However, costs can also be higher for people who leave jobs for early-retirement, sickness or disability benefits (which are sometimes more generous than unemployment benefits). For the family situations considered in Figure 2, the costs of joblessness are the same or larger on the revenue rather than the expenditure side of the public finances in a number of countries, mainly in Continental Europe. The fiscal or budget crisis is therefore not just a spending crisis.

Figure 2. Unemployment is expensive: direct fiscal cost of job loss, 2009

Job loser entitled to unemployment benefits, per cent of GDP per head



Note: Model calculations averaging across different family types (singles and couples with and without children) and earnings levels (for each family type: 67 and 100 percent of the average wage before becoming unemployed). The amounts shown are calculated as the sum of benefit entitlements in the initial phase of unemployment and the direct taxes and social contributions payable in the lost job. Benefit entitlements are based on the assumption of full eligibility of unemployment benefits, and full take up of means-tested benefits where these as available. Social contributions include the employees' and employers' part, as well as any payroll taxes. Knock-on effects on other types of benefits or tax revenues (*e.g.*, lower indirect taxes due to reduced consumption) are not taken into account.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD tax-benefit models (www.oecd.org/els/social/workincentives).

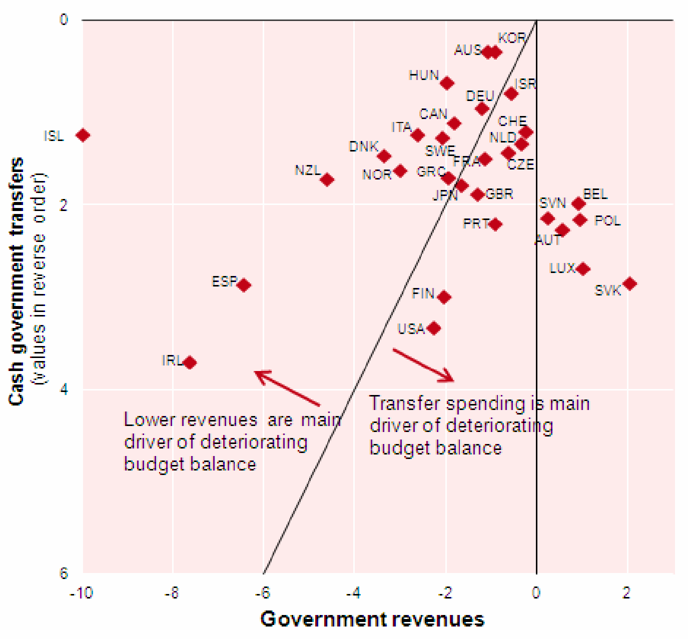
3. The November 2010 edition of the OECD Economic Outlook expected cyclically adjusted (or "structural") deficits to account for more than three quarters of 2012 deficits in the OECD on average. The main drivers of this result were much lower revenue expectations, the remaining costs of fiscal stimulus measures, reduced GDP growth, and increased debt-service burdens.

Recessions cause a slump in a range of important revenue sources (in some cases, corporate revenues have fallen by almost a fifth for example), and are often followed by periods of sluggish revenue growth. Figure 3 looks at the aggregate picture, confirming that reduced government revenues have often had a greater impact on the budget balance than higher benefit expenditures.[4] For instance, if 2010 revenues in Spain had been the same in real terms as in 2007, this would have reduced the budget deficit by more than 6 percentage points. Returning to 2007 benefit expenditure levels would have reduced the deficit as well, but by much less (3 percentage points).

In contrast, in about half of countries, higher public spending on transfers was a more important driver of deteriorating public finances than the decline of all sources of revenue combined. This was, for instance, the case in the United States, and in a range of countries (such as Austria, Belgium, Poland and the Slovak Republic) where government revenues increased between 2007 and 2010.

Figure 3. Budget deficits: changes in public transfers and government revenues

Expenditure and revenue changes 2007-10, real terms, per cent of 2010 GDP



Notes: The vertical axis is inversed (a positive number indicates an increase in social benefit expenditure and, hence, a deteriorating budget balance). Government transfers refer to all cash social benefits paid by government (SSPG series in the OECD Economic Outlook Database). Government revenues refer to total tax and non-tax receipts of the general government sector (central and sub-central, plus social security contributions). Values for 2010 are estimates and are therefore preliminary.

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

This analysis has important implications for social policy and fiscal consolidation strategies. Reversing the recent growth in social protection spending would be a big step towards mitigating fiscal problems. And, realistically, necessary social policy reforms in many countries will indeed need to find ways to "do more with less". But reducing social spending is not sufficient to restore health to the public finances. For

4. Figure 3 shows cash transfers only as detailed data on services spending over the recession are not yet available. Nevertheless, cyclical changes in services spending (especially health, the largest component) tend to be small, delayed and short-lived. Cash transfers should therefore capture most of the variability of total social expenditures in a downturn.

example, in a majority of countries, a return to 2007 levels of transfer spending would have closed less than a third of the budget gap in 2010. Moreover, no OECD country has been able to achieve cuts of this scale in the context of weak growth and elevated unemployment. In several countries, the size of current budget deficits makes it clear that determined measures on both the expenditure and the revenue side would be required to return to fiscal sustainability. Everywhere, employment and earnings growth is essential both for reducing benefit spending, and for shoring up government revenues now and in the longer term.

2. Social policy and inequality: the crisis as a "stress test" for families

Can budget deficits be addressed while minimising the adverse impact on inequality and poverty? And which types of redistribution measures should receive priority when rebalancing expenditures?

Widening income inequalities and, in many cases, increasing poverty rates, were evident before the crisis and are receiving increasing policy attention. While the issue is still debated, inequality has also been argued to be among the contributors to the imbalances that led to the financial crisis. Past experience has shown that it is very difficult to cut social expenditures without increasing inequality. Significant short-term savings require reductions in benefits, and benefit receipt is naturally concentrated among low-income families.

2.1. Income losses and gains during downturn and recovery: how are they shared?

Studies prepared for a recent OECD conference have documented that recessions trigger large losses for some of the poorest income groups.[5] This is of particular concern as the recent recession follows a well-documented medium-term trend toward a more unequal income distribution and, often, increasing rates of income poverty. While the full evidence on the most recent income changes has yet to emerge, data on income gains and losses in earlier economic cycles provide some valuable pointers for policy. Figure 4 shows trends in *market* incomes (*i.e.*, before adding benefits and deducting taxes) in order to illustrate the demand for government support at different stages of the economic cycle. Income trends are shown for eight selected OECD countries and at three points in the national income distribution ("low", "median" and "high" levels of market income).[6]

In the United States, market incomes in the low-income group fell until the mid-1990s despite an increase in labour-force participation. Real incomes subsequently grew strongly until 2000 but then fell back so that at the end of the period, they were the same as they had been in the late 1970s. In the seven other countries shown, and before accounting for taxes and benefits, real incomes in the "low" group are now *lower* than they were at the beginning of available data series. One reason is that employment gains were to some extent concentrated in households who already had some earnings, while the number of *workless* households increased in some cases. A growing number of households with no earnings at all can result in a very steep fall of market incomes at the low end of the distribution (*e.g.*, in Australia, Finland and United Kingdom following the recessions of the mid-1990s, and in Israel and Poland later on). Government transfers are essential for cushioning some of the steep losses suffered by these households, and for preventing them from falling into deep poverty.

In contrast, incomes in the upper part of the distribution have often *continued* to rise during downturns, albeit at a reduced pace (Canada, Denmark and the United States, for example). Where downturns do

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5 . Immervoll, H., A. Peichl and K. Tatsiramos (eds.), 2011, *Who Loses in the Economic Downturn? Economic crisis Employment and Income Distribution,* Research in Labor Economics, vol. 32, Emerald,

6 . This grouping provides one particular perspective on income changes during past economic cycles. Part 3 below looks at the recent labour-market experiences by gender, age and educational attainment.

result in longer-lasting losses for higher-income groups (as in Australia, Finland, Poland), the relative income decline tends to be significantly smaller than for low-income earners. The main exception to this pattern is the 2001-02 recession in Israel: income losses among higher earners persisted, while earnings at the bottom recovered (albeit from a level that was much lower than in the 1990s).

In some recoveries, the lowest incomes grew more quickly than they did at the top (Canada from 1993, Denmark during the 1990s). But this usually followed a period of sharply declining incomes for low earners. As a result, episodes of narrowing income differentials have rarely lasted long enough to close the gap between high and low incomes that had opened up previously. In other countries, market-income gaps stagnated or continued to widen even as low incomes recovered from deep or prolonged labour-market downturns (see Finland and the United Kingdom). The data points are spaced several years apart and therefore do not capture the full income dynamics over the cycle. It appears, however, that any disruptions in the upwards trends for high-income groups during the downturns of the early 1980s and 1990s were short-lived. Importantly, the incomes of the very highest earners (such as the top 1%) are not included in the "high" income series in Figure 4. For this group, very large gains were recorded prior to the downturn in some countries (see Box 1).

Box 1. Income trends at the very top

It is a well known phenomenon that survey data – such as those underlying Figure 4 – under-sample the very highest incomes. However, top incomes are highly relevant to the effectiveness and scope of redistribution policies.

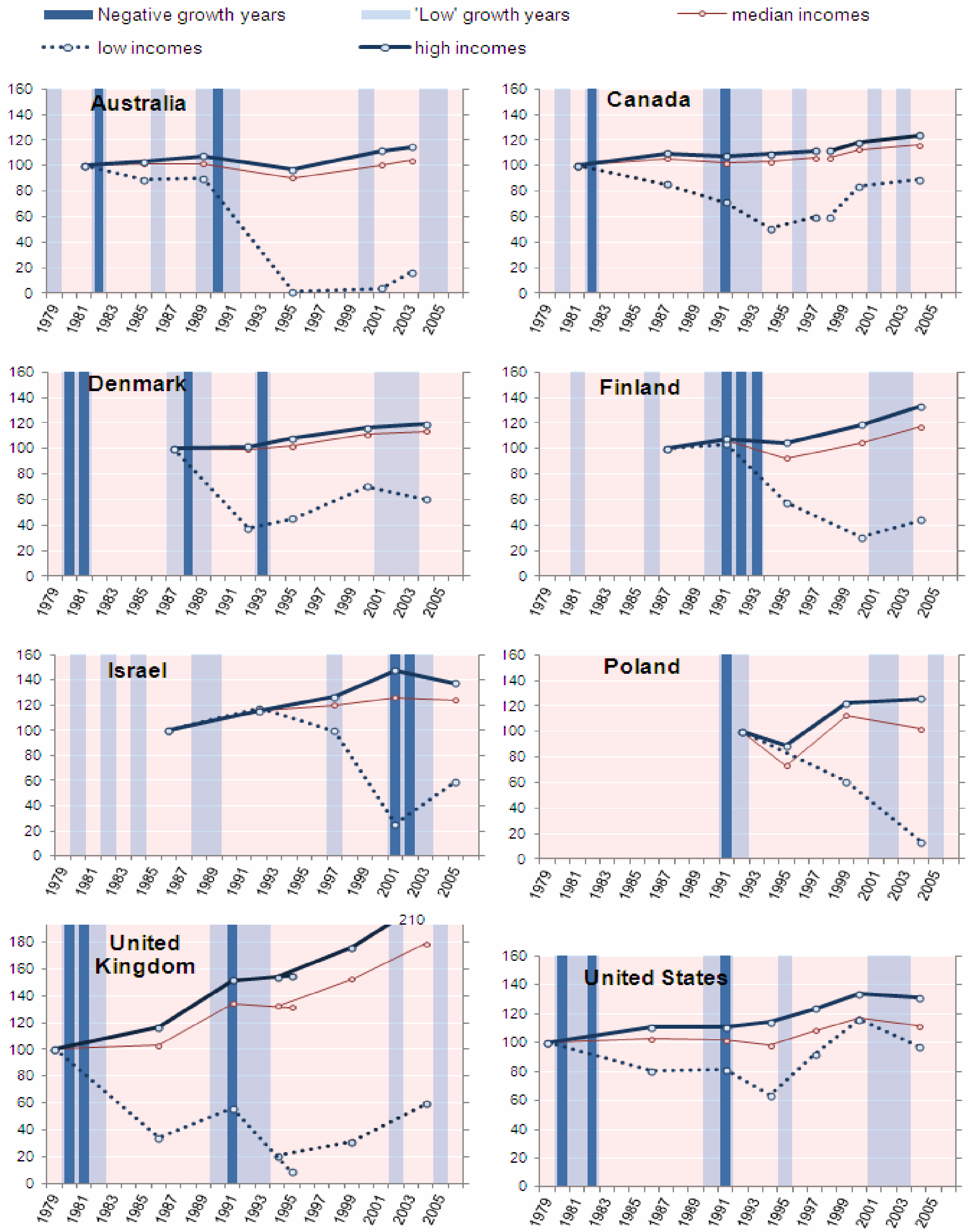
Researchers studying income-distribution trends in the United States reported that "it is the top 5% of households that have gained [since the late 1970s], and the bottom 60% that have lost, in relative shares."[1] Data drawn from tax statistics indicate that during the 2002-2007 boom period, the highest-earning 1% of all families in the United States (those earning in excess of around USD 360 000) accounted for as much as two-thirds of total market-income growth. During the past two to three decades, the increase in "top" income shares were especially pronounced in mainly English-speaking countries (as well as in China and India), but less so in continental Europe.[2]

Recent recessions have resulted in lower "top" income shares, but the drops tended to be short-lived (especially when compared to the Great Depression period). New data for the United States suggest that during the most recent recession, falling "top" income shares were initially mainly a result of much-reduced realised capital gains, while other income sources of "top" earners were much less affected. Similar data covering most of the twentieth century for a wider set of countries indicate that banking crises have reduced income shares at the very top, but not for other "high" earners. Economic booms tended to push up the shares of "top" earners (top 1%) at the expense of other "high" earners (top 90-99%).[3]

1. Lindert, P. H., 2000. "Three centuries of inequality in Britain and America," in: A.B. Atkinson and F. Bourguignon (eds.), *Handbook of Income Distribution*, chapter 3, pages 167-216, Elsevier.
2. See OECD, 2011. *Causes of Growing Inequality in the OECD Area*, forthcoming, and Atkinson, A. B., T. Piketty and E. Saez, 2011. "Top Incomes over a Century or More", *Journal of Economic Literature*, forthcoming.
3. Roine, J., J. Vlachos and D. Waldenström, 2009. "The long-run determinants of inequality: What can we learn from top income data?", *Journal of Public Economics*, vol. 93, pp. 974–988.

Figure 4. Market-income gaps grow during downturns – but often do not close during booms

Household market incomes, constant prices (earliest data point=100), households headed by working-age individuals.



Notes: "Low" and "high" incomes refer to the 10th (UK: 15th) and 90th percentiles of the distribution of household market incomes. "Low" growth periods are the bottom-third growth years during 1979-2005 in each country. Start of series varies due to data availability. Separate series indicate a change in underlying data sources. "Market" income includes private transfers. Initial income gaps between "low" and "high" incomes differ between countries. Comparisons of these gaps should therefore be made over time, not across countries.

Source: Immervoll, H. and L. Richardson (2011), "Redistribution Policy and Inequality Reduction in OECD Countries: What Has Changed in Two Decades?", Social, Employment and Migration Working Paper No. 122, www.oecd.org/els/workingpapers.

2.2. Implications for redistribution policies

These historical patterns are informative for designing policies today, when most OECD countries are emerging from a deep recession with their public finances under severe strain. The data underline the importance of well-targeted government transfers during economic slumps, as well as during the recovery. But redistribution strategies based on government transfers alone would be neither effective nor financially sustainable. In restoring incomes at the bottom, a key challenge for social and labour-market policy is to facilitate employment and earnings growth that benefits low-income groups in particular. This requires not only new jobs, but jobs that enable people to avoid and escape poverty. Recent trends towards higher rates of *in-work* poverty indicate that job quality has become a concern for a growing number of workers. The current labour-market slack, and a resulting unfavourable bargaining position of marginal workers in particular, adds urgency to policy reforms that tackle inequalities in the labour market, such as those between standard and non-standard forms of employment.

The relative stability of higher incomes – and their longer-term trends – are also important to bear in mind in planning fiscal consolidation measures. A number of countries with large revenue needs (such as Greece, Ireland, Portugal, United Kingdom) have recently raised tax burdens for higher earners, involving both increased income-tax rates and a broader tax base. Realistically, and as illustrated by the broad set of other tax measures taken in these countries, much more additional revenue is needed than what can be collected from income taxes only and, specifically, from high incomes alone. Concerns about economic efficiency and the implications for economic growth must also be borne in mind, especially when increasing tax rates (rather than broadening the base). However, the historical income trends do signal a significant shift in the relative "tax capacity" of lower and higher-earning groups in the aftermath of steep downturns.

It may therefore be necessary to critically review whether existing tax provisions should be adapted in light of equity considerations and current revenue requirements, in particular where those with high or very high incomes have benefited from declining overall tax burdens in the past (*e.g*., because of non-compliance, because tax expenditures mainly benefit high-income groups, or because of lower property and wealth taxes). In these cases, progressive tax increases, *e.g.*, by improving compliance and broadening tax bases, can indeed be a better way of raising additional revenues for fiscal consolidation. Reforms in this direction also help to offset some of the growing gap between high and low incomes.

Costs and benefits of targeting

In practice, fiscal consolidation is likely to be achieved through a mix of revenue and spending measures. And in each case, appropriate targeting 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 as well, targeted measures can help to make fiscal consolidation measures more equitable. Further means-testing can reduce benefit expenditures while protecting the most vulnerable. At the same time, benefit cuts are likely to contribute to higher inequality, if transfers are already highly targeted. Means testing also imposes economic costs. Work disincentives associated with targeting on family income are likely to become more damaging once labour demand starts to pick up during a recovery. In addition, means-tested programmes often suffer from low benefit take-up, resulting in poor coverage among the targeted population and less success in reaching vulnerable groups.

Targeting on *behaviour* or *non-income characteristics* is an alternative that can produce cost savings, while leaving 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. The concept of "*mutual obligations*" also makes benefits conditional on claimant behaviour and aims to restore self-sufficiency and prevent long-term benefit dependency. Again, these are examples of positive externalities created by targeting. As more job vacancies are posted during a recovery, there is indeed a stronger case for linking benefit receipt more tightly to job-search or availability-for-work requirements. In the context of fiscal consolidation, an important consideration is the need for adequate administrative and operational resources to enable an effective implementation of "mutual obligations" and other targeting measures.

2.3. Social policy as an investment in the future

Beyond immediate redistribution, the timing and targeting of fiscal consolidation has longer-term consequences, although 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, for instance, that programmes leading to early withdrawal from the labour market (early retirement or quasi-retirement payments, disability benefits) create large and practically irreversible increases in social expenditure. While often politically difficult, tightening the availability and generosity of these payments is an effective way of reducing social expenditures now and contributing to safeguarding future fiscal sustainability in the face of ageing populations and workforces. Without effective gate-keeping, there is a high risk that expiring entitlements to unemployment benefits trigger significantly greater inflow into so-called "inactive" benefits.

Other policies have a social investment character with short-term cost but provide potentially attractive future payoffs. These include active labour market policies that prevent unemployment from turning into long-term benefit dependency, especially among the young, and programmes that help reconcile work and family life (the effectiveness of these policies is discussed in Part 3). Measures that safeguard child well-being, especially during the formative years of early childhood, are also a priority area. While contemporaneous poverty is of concern in itself, the adverse long-term consequences of child poverty are well documented. These "scarring" effects of low-income spells mean that when the recession ends, its impacts on children do not. The provision of adequate, uninterrupted and active support for the least well-off is therefore a central and critical element of social protection, especially at a time of elevated poverty risks.

Publicly provided services or goods can be an integral part of carefully balanced support for vulnerable groups, such as children, job-seekers, individuals with health problems or groups facing extreme economic hardship (*e.g.*, the homeless). As recently argued by the National Inequality Panel in the United Kingdom, the provision of public services can be an effective way of making access to important aspects of life less dependent on income. As a result, service cuts can be a particular concern when a large number of people cannot afford market-based services. They may also hinder an effective policy response to severe labour-market problems. For instance, cuts to education budgets can exacerbate the future problems arising from the very steep increase in youth unemployment (see next section). Likewise, budget cuts can reduce the capacity for implementing new or existing redistribution and labour-market programmes. Savings measures instituted at different levels of government can result in considerable additional co-ordination challenges, notably in federal countries like the United States, with devolved responsibilities for these programmes.

Furthermore, while scaling back service infrastructure produces short-term savings, these may not translate into longer-term efficiency gains if significant human or institutional capital is lost in the process. There can therefore be trade-offs between quick cost-cutting fixes (such as budget ceilings or envelopes), and measures to improve longer-term efficiency. These trade-offs are likely to be important in the case of services which will see increasing demand in the future (*e.g.*, childcare, long-term care). When responding to cyclical fiscal pressures, one relevant consideration is that service cuts are typically not easily reversed, so that *temporary* reductions in service capacity can create greater future costs than temporary changes to cash transfers or taxes.

There are good reasons for prioritising some areas of social expenditure over others. Yet all major spending items must be reviewed to yield short-term savings, including politically sensitive areas such as old-age pensions. While reforms to retirement-income systems quite rightly focus on long-term financial sustainability, short-term changes might help to spread the burden of fiscal adjustment more equally across income and age groups. In principle, this approach would be best suited to countries where public pensions are relatively high (and so retirees were not significantly affected by the financial crisis). There are, however, often legal and political hurdles to changing the accrued rights of pensioners, and so savings typically have come from delaying or suspending benefit increases. Poverty rates among older people have fallen in most countries over the past two decades, while poverty among young adults and children has become more widespread. Nevertheless, old-age poverty remains a challenge in many countries, and so cost-saving measures should be targeted so as to protect low-income pensioners. Fiscal gains might also be reaped by limiting special tax treatment of retirees or retirement incomes, which typically benefit better-off pensioners in the main. Part 4 of this paper highlights some of the recent reforms that OECD countries have introduced.

3. A job-rich recovery

Both the current fiscal situation and inequality trends discussed in the previous sections underline the need for economic growth to be accompanied by strong employment creation: a "job-rich" recovery.

3.1. Patterns of problems in the labour market

The recent economic downturn had a global reach. Output fell in most OECD countries almost simultaneously, while growth in emerging economies slowed significantly. But the depth of the recession within the OECD varied significantly. Contractions were small in Australia and Poland. In contrast, real GDP fell by 10% in Finland and Japan and by substantially more in Estonia, Iceland and Ireland (Figure 5). There were also significant differences between countries with similar drops in GDP. Some countries – such as Japan, Mexico, Netherlands, Slovenia and Sweden – were remarkably successful in limiting initial employment and earnings losses despite large falls in economic output. In others, such as Spain and the United States, the jobs crisis has been deeper and more persistent than expected.

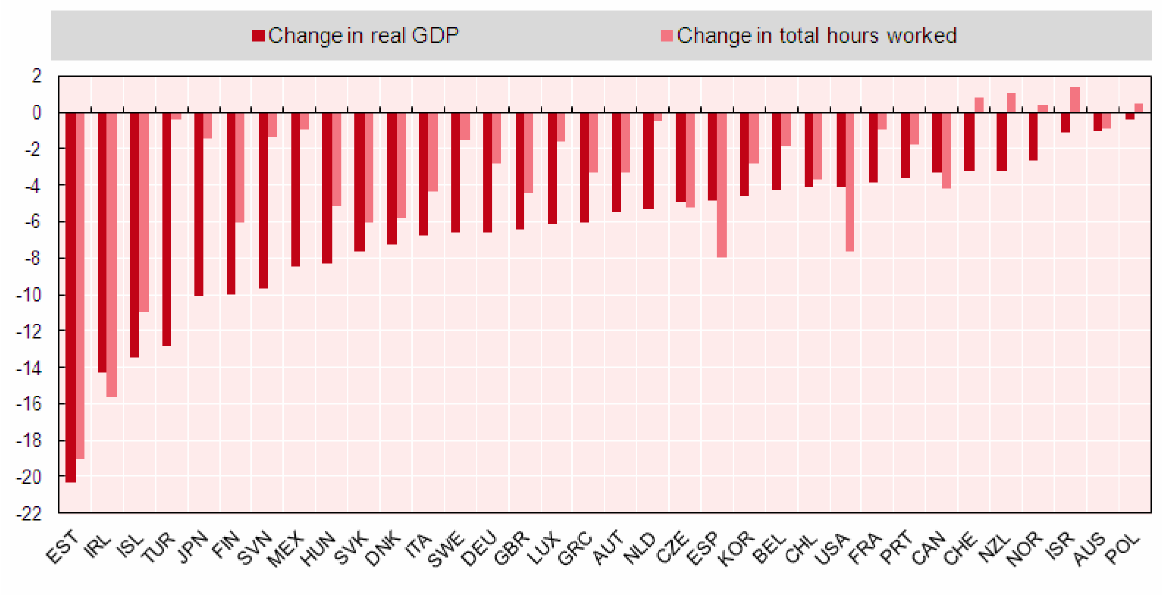
Although the impact of higher unemployment has been felt throughout the economy, some groups are much more likely to face difficulties in the labour market. Historically, downturns have tended to hit already disadvantaged groups, such as youth, low-skilled and temporary workers, disproportionately. Figure 6 (panel A) shows that this has also been the case in the most recent downturn. The graph also highlights that employment rates have *continued* to decline after the third quarter of 2009, when GDP was already recovering in most OECD countries. The very large increase in youth unemployment is a particular concern as those failing to gain a foothold in the labour market are known to suffer low productivity and a range of social problems not only now, but also later in life.

Some patterns of labour-market problems differ from earlier recessions, however. In part, this is because the structure of labour markets was different this time compared with earlier cyclical downturns. The share of employees in temporary jobs, for example, increased by about a fifth in the decade to 2007 in the EU15 states. At the start of the crisis, non-permanent jobs accounted for one in five workers in Poland and Portugal and nearly one in three in Spain. Temporary work has also become substantially more significant in Japan and Korea. During a downturn, temporary workers are much more likely to lose their job than those on a permanent contract. As a result, their greater numbers may contribute to large and rapid increases in total unemployment.

Employment rates of older workers, on the other hand, have tended to *increase* both in the recession and in the recovery that followed. In view of the demographic challenges facing OECD countries, this is clearly a positive development and in stark contrast with previous experience, when older workers were more likely to lose their jobs than people of prime age. One reason for this change is that pension reforms in many countries have restricted access to early retirement in public pension schemes and made it financially less attractive. A few countries, including Hungary, Italy, the Netherlands and Poland, have also introduced comprehensive disability-benefit reforms. Another explanation is that this downturn coincided with a financial crisis, unlike the recessions of the early 1980s or early 1990s. In countries where private pensions are a significant source of retirement income, losses in private pension assets may have encouraged people to postpone their retirement, if possible.

Figure 5. The financial crisis led to a jobs crisis, but some labour markets were remarkably resilient

Changes in GDP and total hours worked during the recession, in percent

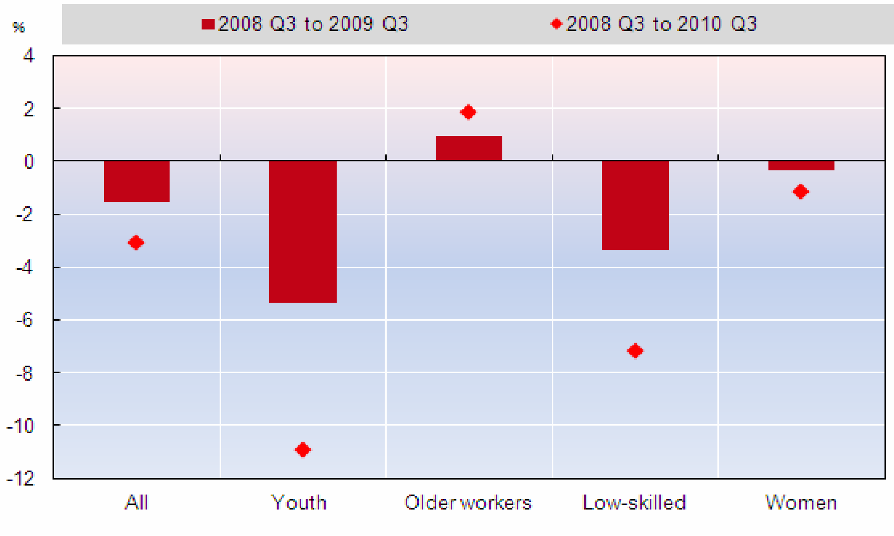


Notes: Changes are assessed from GDP peak to through in each country. For Israel, Switzerland and Turkey, changes refer to employment levels as comparable data on total hours are not available.

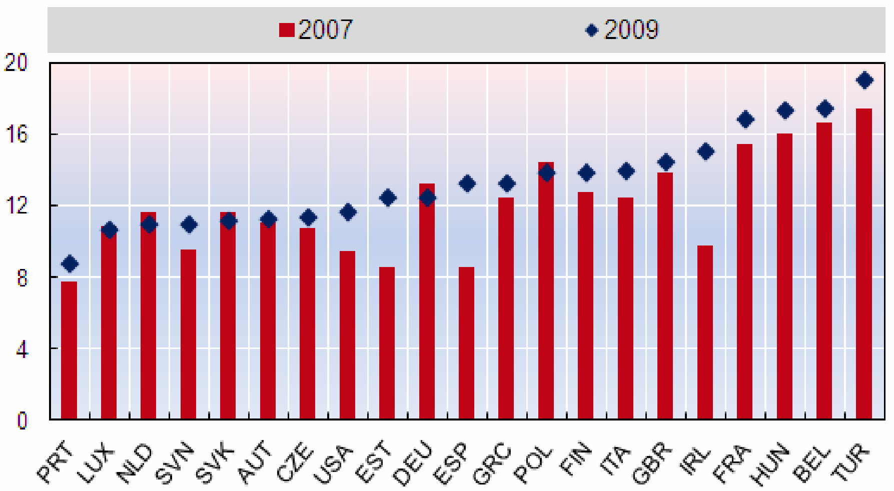
Source: OECD Labour Force Statistics and Main Economic Indicators.

Figure 6. Employment trends for different population groups

Panel A. Change in employment-to-population ratios
unweighted average across 31 OECD countries, in percent



Panel B. Share of individuals living in workless households
working-age population (15-64), in percent



Note: Households are defined as "workless" if all household members are either unemployed or labour-market inactive.

Sources: OECD Employment Database and OECD estimates based on the European Union Labour Force Survey and the United States Current Population Survey.

Female employment has generally suffered much less than that of men in the recent crisis. Again, this is a notable deviation from historical patterns which 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.

Yet, an individual perspective on labour-market experiences gives only an incomplete picture of families' difficulties. Panel B of Figure 6 shows that the proportion of people living in households without any income from work has gone up almost everywhere, and has increased by some 50 percent in Estonia, Ireland and Spain. In debates on fiscal consolidation and other policy reforms, these households deserve special attention as they are particularly vulnerable and highly dependent on government support. With more than one in eight working-age persons now living in workless households in most countries, the success of redistribution measures and active social policies depends to a large extent on whether outcomes can be improved for this specific group.

3.2. Active social policies

Households try to adapt to an economic shock, such as a major loss of income, in order to minimise the effects on their living standards. A range of adjustment mechanisms exist, including a change of spending patterns, borrowing or drawing down savings and relying on family support (see Box 2). A primary response is to seek alternative earnings opportunities. For many households, this may not be successful in the depths of recession, although evidence shows that a large number of new jobs are created even then. But prospects improve as economic recovery begins to take hold.

Box 2. Household resilience and family support

Families share resources during all phases of the economic cycle, but family-based support is of particular significance when economies are weak. The flip side of greater economic security for family members affected by unemployment or financial losses is a greater demand on the resources of other family members or friends whose own jobs and personal savings are safe. Widespread unemployment or troubled pension investments can be expected to lead to greater demand for intergenerational support. There is, for example, recent evidence of large numbers of unemployed youth in the United States returning to the parental home, or not moving out in the first place. Those depending entirely on family support even before the recession, notably children, are particularly likely to suffer as a result of widespread income losses, and to benefit from a speedy recovery.

Despite the importance of “vertical” support between generations, “horizontal” support – between spouses or cohabiting partners, for example – plays a bigger role in stabilising household incomes. Women’s existing earnings have a straightforward income-stabilising effect for families. As discussed in the main text below, the sustained growth of women’s labour-force participation over the past decades has boosted many families’ abilities to cushion losses.

At the same time, however, households are getting smaller, with growing numbers of single-person and lone-parent families and fewer multigenerational households. Single-adult households obviously face a complete loss of earnings in the event of unemployment. Lone parents in particular face many constraints, such as the need to maintain existing childcare arrangements, which may limit their ability to respond quickly to income shocks because of restricted mobility, both geographically and between jobs. One implication of these constraints is that, for lone parents and their children, a continuity of child-support payments and employment-friendly government support is crucial across the economic cycle.

Such household “coping strategies” are an important way of dealing with the challenges posed by income losses. There is a strong case for designing government support in ways that harness and complement – rather than replace – households’ own capacities to adjust to adverse circumstances. For instance, a new OECD study suggests that countries that invested heavily in active labour market policies already *before* the crisis were successful at limiting its adverse impact on employment levels.[7] At the same time, transfers and other forms of government support will always be needed. In general, consumption smoothing is more difficult for low-income households who are therefore more dependent on government transfers for “pushing through” low-income spells, even if they are temporary. An important policy objective is to avoid situations that force households to cut down on the consumption of necessities (such as food, shelter and essential health care) or compromise future prospects (for example, by disrupting education).

7 . The results are reported in the 2011 edition of the *OECD Employment Outlook.*

How to strike the right balance between public support and encouraging adaptability and self-sufficiency is one of the most crucial questions in social policy. After a deep recession, the stakes are especially high. On the one hand, the social consequences of inadequate government support grow with the number of people facing economic hardship. On the other hand, the payoffs of successfully promoting self-sufficiency are also greater, as it alleviates fiscal pressures and facilitates economic recovery.

The high fiscal cost of joblessness reinforces the case for well-funded active social policies, even if these are costly in the short term. But fiscal constraints may require a rapid transition from broad, stimulus-type programmes to selective and customised employment support. The short-term cost of creating an extra job through broad reductions in non-wage labour costs (such as employer social security contributions) can be very high – more than 150 percent of average earnings according to OECD calculations. More targeted programmes (such as subsidies for new hires only) are much less costly in aggregate, but success rates can be low if they focus on disadvantaged groups which are more difficult to get back into work. Job-search assistance is particularly effective for those with relatively recent labour-market experience. For others, especially the young, training measures are an option. Some evaluations of on-the-job training show significant longer-term economic benefits, while classroom-type training frequently inhibits effective job-search.

In summary, the costs and performance of different types of active social policies vary substantially and some provide quicker results than others. Channelling scarce resources towards the most efficient programmes is essential when budgets are tight. In addition, individual programmes are unlikely to be equally well-suited in different phases of the economic cycle, and the best combination of policies will depend on labour market conditions as well. A frequent evaluation of whether policies in their current form are still meeting their objectives is therefore important, especially while economic conditions remain volatile. For instance, as the recovery gains momentum and promoting labour supply becomes more important, there is a case for shifting the focus of active labour-market policies from labour-demand support (wage subsidies *etc.*) towards in-work support for low-income working families. Nevertheless, well-targeted wage subsidies for individual groups, such as youth, may be effective even as *overall* labour demand picks up during the recovery. More generally, and as shown above, crisis-related labour-market problems differ substantially between groups and a review of policies in this area needs to account for these differences.

3.3. Female employment is a key contributor to household resilience

Active policies are more successful at restoring self-sufficiency, if they account as much as possible for the family situation of jobless individuals. To date, policy responses to the crisis have mostly concentrated on individual job losses and less on the situation of households and families (Part 4 discusses policy changes in detail). To be as effective as possible, work-related support should not be restricted to individual job losers, but directed at non-working partners as well.

More women now have current or recent labour-market experience than in previous recessions. This has increased their chances of successfully compensating some of their partners' earnings losses, either by finding a job, or by working more (this is often referred to as an "added-worker" effect). Households where both partners engage in active job search are better able to minimise income losses in the event of unemployment, and are also in a better position to benefit quickly from improving labour-market conditions.

Whether or not partners of job losers are in fact likely to search for – and find – employment, depends on a number of factors. For instance, it is not clear whether a recession would strengthen or weaken the "added-worker" effect. On the one hand, accelerating job losses, less stable employment patterns during the year and reduced working hours clearly create a greater need to compensate a drop in household income. On the other, the weak labour market makes it harder to do so.

New labour-market data show how important female employment is to reduce economic hardship (Figure 7). Job loss and working-time 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 (Panel A). Working-hours reductions were also sizable in some of the countries showing little change in unemployment (Austria, Germany). With the exception of Switzerland, women's working hours have *increased*, or have fallen less than for men in all of the countries shown. Panel B of Figure 7 shows that partnered women were significantly more likely to work more than singles, which also points to an "added worker" effect.

For women who are already employed full-time, working significantly more is not an option. In many countries, a large number of women work part-time, however, leaving considerable scope for increasing total working hours even in countries where female employment rates are comparatively high, such as France or the Netherlands. In a few countries (including Ireland, the Netherlands and New Zealand), additional hours worked by women were 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.

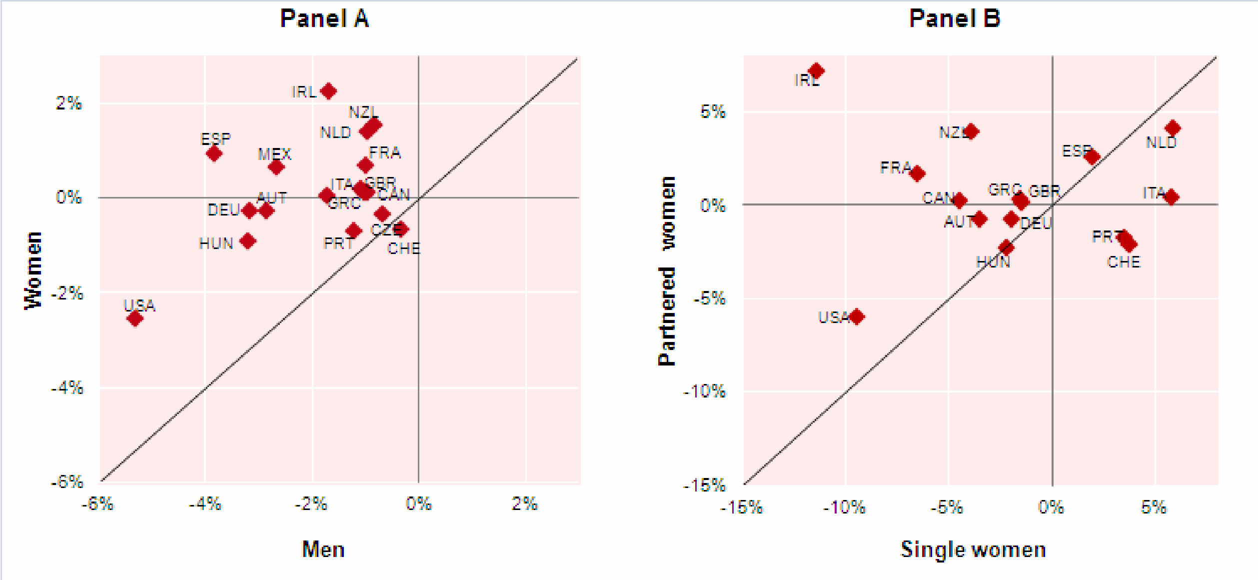
The degree to which partnered women were able to compensate for their partners' earnings losses varies between countries, and policy factors are likely to play a decisive role here. The perceived need for women to find employment or seek longer hours may be limited if men's earnings losses are seen as temporary (as a result of short-time working schemes, for example) or are largely compensated by government transfers. In addition, disincentives created by taxes and out-of-work benefits can affect job search and/or work effort, not just for the principal earner in a household, but also for second earners. Means-tested unemployment benefits, which are reduced once a partner starts to earn more, can be a big obstacle for boosting female employment.[8] This is an important policy challenge, as those entitled to means-tested benefits have very low incomes and would therefore have a lot to gain from an "added-worker" effect.

Labour-market institutions that allow swift adjustments of work patterns combined with help to overcome family-related employment barriers (such as the need to find childcare) can support added-worker effects, while persistent gender-wage gaps limit women's ability to help stabilise family incomes. Policies that address gender-specific employment barriers tend to strengthen families' resilience to economic shocks, and improve their prospects of benefiting from a recovery. The current momentum in many countries towards a more equal sharing of market work in the household implies that the on-going recovery presents a distinct opportunity for making progress on the gender-equality agenda.

8 . This is shown in a recent OECD report: Immervoll, H. and L. Richardson (2011), "Gender Wage Gaps, Work Incentives and Public Policies to Reduce Gender Inequality".

Figure 7. 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



Notes: Changes in panel A are shown relative to *family* pre-crisis hours (*i.e.*, the sum of men's and women's hours). Changes in panel B are shown relative to *individual* pre-crisis hours in the respective groups. Changes capture differences in both employment levels *and* average hours worked in a job. They are measured as total hours in the four latest available quarters minus total hours in the four pre-crisis quarters in each country.

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

4. Policy developments

4.1. Benefit expenditures after a downturn: how do current trends compare?

Historically, cuts in benefit expenditures during fiscal consolidation phases have been slow compared with the rapid spending growth during recessions. For instance, an OECD analysis of spending data shows that, in the past, a 10 percentage-point rise in the debt-to-GDP ratio in the previous year was associated with a 0.4 percent cut in real benefit spending. Annual spending increases in a recession were typically ten times as large.[9]

These links between social spending levels and key economic variables, such as unemployment and economic growth, provide a useful context for discussing current social expenditure trends. Figure 8 compares current expenditure changes ("observed" and "announced", dark bars) with those that one would see if each country reacted in the same way to economic fundamentals as the average OECD country did during the past three decades ("expected", light bars).[10] The left-hand panel shows expenditure increases in the early phase of the downturn, while the right-hand panel looks at spending changes that countries have announced for 2011 (the "announced" changes are Secretariat projections based on policies known or implemented by autumn 2010).

9 . Expenditures on services and in-kind benefits are not considered in these results, but are generally much less cyclical than cash spending. See footnote 2.

10 . They therefore should not be interpreted as guidelines for what individual countries *should* be aiming for.

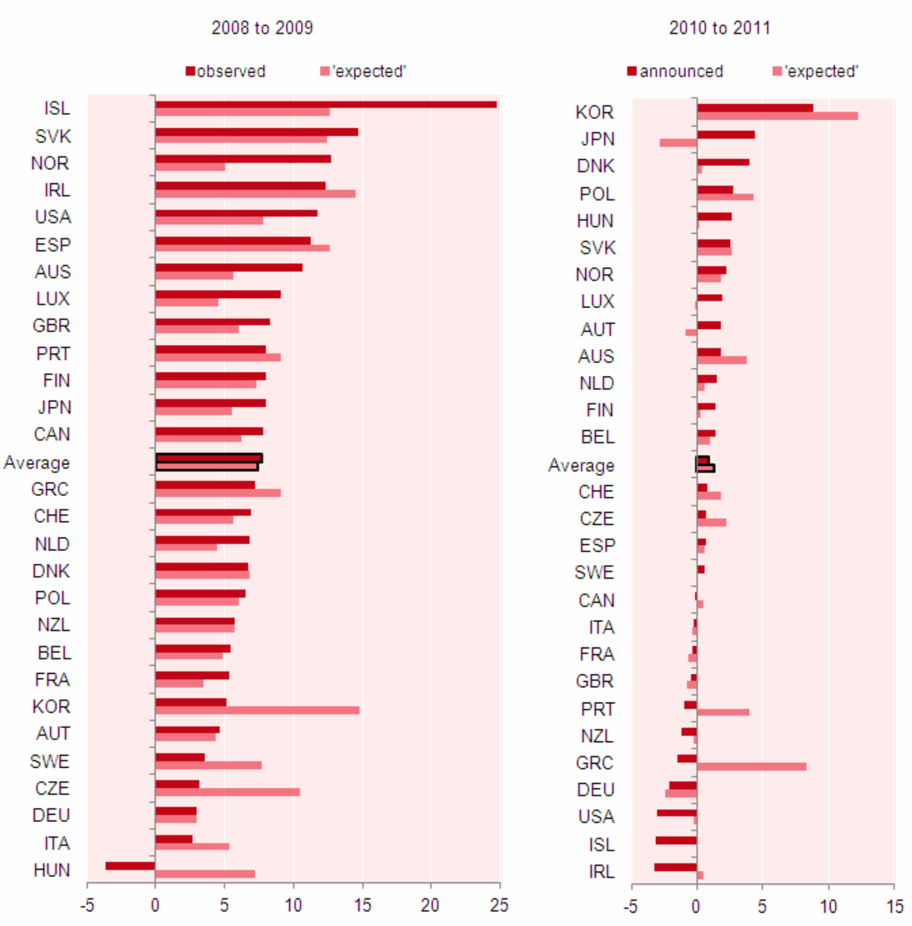
Among the OECD as a whole, total social transfer spending has responded in about the same way to economic developments as it did in the past. Following the sharp drop in economic output in 2009, total benefit spending increased by about 7.5 percent in real terms (left-hand panel). Given the projected persistence of unemployment into 2011, past experience would suggest a small real-term *increase* of social benefit spending compared to 2010, in spite of high deficits in most countries and very high debt levels in some (right-hand panel). On average across countries, the announced spending plans for 2011 match this expected change.

Different initial policy responses to the downturn explain why some countries have seen much larger or smaller spending increases during 2009. Some have adopted sizable discretionary stimulus packages with a strong focus on supporting household consumption. In Australia, for example, most measures in 2009 were one-off or strictly temporary (as a result, spending fell strongly in the following year). Norway saw a big year-on-year increase in incapacity benefit expenditures, which accounts for a large share of the overall spending increase of more than 12 percent in 2009. In Iceland, unemployment benefit expenditure more than quintupled from 2008-2009. Spending on the quantitatively much more important incapacity support rose only comparatively little, however, while spending on old-age pensions declined. In a few other countries, the recent recession has resulted in much smaller expenditure increases than past spending patterns would suggest. In Korea, spending on unemployment benefits grew strongly between 2008 and 2009, but overall transfer spending rose by much less than expected. This is because growth in expenditure on old-age and, especially, social assistance benefits slowed significantly relative to the pre-crisis years when the coverage of these programmes was actively expanded. In the Czech Republic and Hungary, spending growth before the crisis was also high, leading to an expectation of even higher growth for 2008-2009 based on past experience. This did not materialise as both governments actively sought to hold spending down.

Nine countries were planning to cut real spending on social transfers in 2011, most of them in the context of persistently high unemployment and weak growth. Among this group, Iceland, Ireland, Greece and Portugal face substantial market and institutional pressures to restrain the growth of government debt. Their planned spending is therefore much lower than past trends would indicate. Current deficits are also large in the United States, which recorded the second-highest growth in benefit spending in the OECD between 2007 and 2010, after Ireland. When the 2011 spending projections were prepared, the United States also looked likely to cut spending by a substantial margin, as is shown in the graph. However, extended unemployment benefits have since been renewed through 2011 (in addition, national data on benefit expenditures have been revised). These developments will probably bring 2011 spending closer to the “expected” value indicated in Figure 8. In Denmark, Hungary and Japan, policy developments indicate that spending growth in 2011 may be significantly higher than trends in economic fundamentals might suggest.

Figure 8. Social expenditure expansion and containment after the crisis

Real spending per-capita on social transfers, year-on-year change, in per cent



Notes: Expenditure levels refer to social benefits paid by government (SSPG series in the OECD Economic Outlook Database). "Announced" changes are based on Economic Outlook projections, which account for policy measures announced or implemented by autumn 2010. "Expected" changes are based on an econometric model using country panel data of spending on social benefits spanning three decades prior to the recent economic crisis. The model specifies (changes) in real-term per-capita spending as a function of a number of key economic variables (unemployment, government debt, female employment rates, government revenues, GDP growth, and a "recession" dummy), as well as a full set of time-period and country dummies that capture country-specific trends. "Expected" changes for 2010-2011 are then calculated by applying the estimated model to projected values of these variables taken from the Economic Outlook Database.

Source: OECD (2010), Economic Outlook, No. 88.; D'Addio, A.C., H. Immervoll and A. Llena-Nozal (2011), "How Responsive Is Social Benefit Spending to Changing Economic Conditions?", unpublished manuscript.

4.2. Earlier crisis-related measures

Increasing expenditures on social protection in the aftermath of economic downturns are a natural consequence of their role as an insurance mechanism for families and an automatic stabiliser for the wider economy. By increasing social protection budgets, OECD governments have allowed these automatic stabilisers to operate. If social and labour-market policies succeed in preventing long-term benefit dependency and re-establishing self-sufficiency, this automaticity should work in the opposite direction as well: social expenditures should recede as families and the economy recover.

In addition to automatic spending increases, however, discretionary stimulus packages implemented from 2008 onwards were often designed to sustain household consumption, both to protect families' living standards and to bolster aggregate demand. Relevant measures included tax cuts or more generous benefit payments. Many packages also sought to support labour demand. As crisis-response measures, these policies were frequently time-limited (*e.g.*, one-off payments or simple top-ups of existing benefits). As with automatic stabilisers, expenditure increases should be temporary in these cases. Some discretionary measures were in fact discontinued earlier than originally planned (*e.g.*, more generous unemployment-benefit provisions in Portugal and lump-sum top-ups for benefit recipients in Greece). Others, in the Czech Republic, for example, were not implemented at all, as governments faced greater-than-expected fiscal constraints. Some temporary provisions were, however, extended – in some cases repeatedly (*e.g.*, short-time working schemes in Germany, longer durations of unemployment benefit in the United States).

Using recent information that countries have provided to the OECD Secretariat, Figure 9 summarises changes in tax/transfer policies since mid-2008, which were still in place by mid-2010. It shows the proportion of countries that have made different provisions more or less generous over the two-year period.

Unemployment benefit amounts remained more generous than in 2008 in only about one in ten OECD countries. Less demanding eligibility conditions and longer benefit durations were kept in place more frequently (*e.g.*, in Japan in order to facilitate access for non-standard workers), although a few countries have started to reduce durations to less than before the crisis (*e.g.*, Denmark, Ireland). Assistance benefits (social assistance or unemployment assistance) were higher in 2010 than in 2008 in over a third of countries, but changes in eligibility conditions or improved availability of cash housing benefits were rare (even in countries affected by major crises in the housing market). Despite the importance of women's employment for families' income security, almost no OECD country has so far modified means tests to address the disincentives faced by second earners specifically.[11] Around one fourth of OECD countries have, however, sought to improve work incentives by extending in-work support (*e.g.*, by providing additional support for childcare).

Family-related benefits have generally been made more generous with more than half of countries providing additional help to families with children. Such measures were, however, not more frequent in countries with high rates of child poverty. Only a few countries have reduced benefits or tightened eligibility criteria for some family programmes (Estonia, Hungary, Iceland, Ireland). But in addition to the already-implemented changes shown in the graph, several countries have announced future reductions for some or most families with dependent children (Czech Republic, Denmark, Germany, Luxembourg Portugal. United Kingdom).

Old-age cash benefits account for 17 percent of all government expenditure in the average OECD country, and more than one fourth in some of them. Because spending on old-age benefits reflects long-term financial commitments and entitlements, it tends to be much less cyclical than expenditures supporting working-age individuals and their families. But if support for the elderly (or the tax treatment of pensions) contributes little to budget consolidation, this implies greater cuts for working-age individuals, which is the group who is already bearing the majority of crisis-related income losses.

A range of measures mainly reflected longer-term concerns about the large and growing costs of paying public pensions (bottom left-hand panel of Figure 9). Nearly one in three countries announced increases in pensionable ages, including the Czech Republic and Hungary to 65, Australia and Germany to 67 and the United Kingdom to 68. Nearly one in five took other measures to reduce pension costs. But in some of the countries with large consolidation needs (*e.g.*, Ireland), support for retirees was not a significant

11 . Austria has improved second-earner incentives: free health-insurance coverage for unemployed individuals now continues even if the main benefit payment stops as a result of the family means test.

contributor to the often far-reaching savings measures announced to date. In others, pensioners are contributing to short-term consolidation measures. Short-term measures included changes in the indexation of pensions in payment (in Iceland, Portugal and several other countries). Countries with high pension spending were more likely to take steps to reduce public pension expenditures. At the same time, however, permanent improvements in old-age safety-net benefits were implemented or announced in more than a quarter of countries, including Australia, Greece, Korea and Spain all of which had above-average rates of old-age income-poverty before the crisis, on OECD standard measures. Some, such as Iceland, have combined overall expenditure reductions with improved safety nets in order to protect the least well-off.

Changes to personal income taxes and social security contributions were at least as common as measures on the benefit side (bottom right-hand panel of Figure 9). Around a third of countries increased contributions levied on employees and nearly a quarter on employers. Cuts to employer contributions or payroll taxes, which aim to support labour demand, were, however, also common. Around half of countries cut income taxes while a third took measures to increase them. Tax changes – including tax concessions for high-income earners – were more likely in the 12 countries that experienced significant declines in total government revenues. A few countries changed tax provisions that apply to pensioners, although no country appears to have raised tax burdens for pensioners specifically. In Sweden, tax allowances for pensioners were instead made significantly more generous in order to offset some of the pension cuts resulting from an automatic balancing mechanism. Finland has also provided additional tax concessions for pensioners.

4.3. The reform agenda: looking ahead

The downturn has added urgency to a range of structural policy issues. This presents an opportunity to renew the momentum of reforms that were already on the agenda prior to the economic crisis. At the same time, there can be a risk that severe short-term policy constraints inhibit – or reverse – progress on reforms that are known to create significant future benefits. For instance, fiscal pressures may lead to funding cuts for work/family reconciliation and other active social policies that are needed for boosting activity rates. Conversely, a continuing rise in long-term unemployment could prompt governments to ease access to early-retirement or disability programmes.

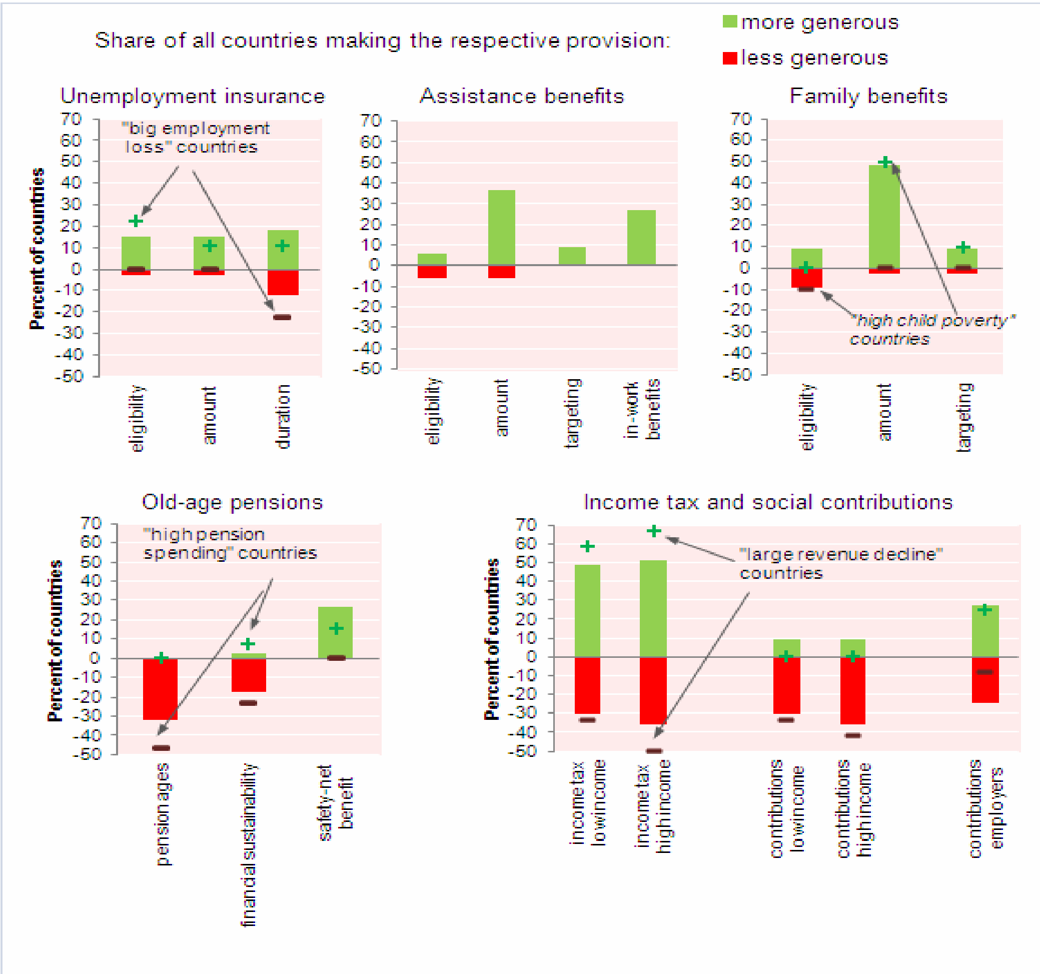
In countries that have experienced mild to moderate downturns, important reforms were frequently going ahead as planned before the crisis. These included measures towards improving the financial sustainability of public pensions (Australia, France, Norway, Sweden), new or strengthened work/family reconciliation programmes (*e.g.*, a new paid parental-leave scheme in Australia and more generous subsidies for non-parental childcare in Austria and Norway), as well as intensified activation measures (*e.g.*, Netherlands, Sweden). Better provision of childcare and extended access to parental leave were also implemented as planned in Portugal, despite budgetary pressures. Planned pension reforms, such as increased statutory retirement ages, were generally also kept on track in countries with large or very large falls in GDP or employment (*e.g.*, Japan, Slovenia). Others accelerated pre-crisis plans towards increasing effective retirement ages (Finland, Greece, Hungary, Netherlands, Spain), strengthening targeted support of low-income retirees (Chile, Greece) or introduced new initiatives to reduce future pension expenditures (Estonia and, to a lesser extent, Ireland).

A common policy response to the recessions of the 1970s and 1980s was to reduce pensionable ages or make access to early-retirement or incapacity benefits easier. Such policy changes result in greater inflows into "inactive" benefit programmes, and have led to an increase in inactivity rates which persisted for a very long time. This time, governments resisted the pressures to repeat such policies, with only a couple making very minor adjustments. For instance, Belgium has provided a small top-up payment for long-term recipients of incapacity benefits. Korea has introduced a new disability pension, which is, however, targeted to the severely disabled incapable of working. In a few cases, certain measures to facilitate longer working lives were, however, put off after the crisis. For instance, Austria delayed both the planned tightening of access to the part-time programme for older workers, and the phase-out of the unemployment transition "pre-retirement" benefit. Even in the absence of policies that ease access to early retirement or incapacity support, lengthening unemployment spells tend to push up the numbers of people receiving "inactive" benefits. In the aftermath of a recession, additional measures that prevent disability and early retirement from becoming substitutes for long-term unemployment are therefore particularly urgent.

As one of the countries severely affected by the crisis, Estonia introduced far-reaching measures to reduce social expenditures in a context of rapidly falling employment rates. Social policy reforms enacted before the crisis, including better income protection for the unemployed and a greater emphasis on active services, played an important role in mitigating its adverse consequences. Benefits that redistribute *horizontally* (cash benefits for families with children) saw significant cuts, while some aspects of *vertical* redistribution were strengthened in order to ensure support for the least well-off (*e.g.*, by increasing the budget for the Subsistence Benefit). Concerns over the wider social implications of very large increases in unemployment have also led to the extension of health-insurance coverage to all registered unemployed (only benefit recipients were covered previously). Sickness benefits were made less generous, while employer costs associated with layoffs were reduced in order to facilitate restructuring and support labour-market dynamics for the recovery.

One of the main policy challenges in the aftermath of the crisis was to ensure adequate and employment-oriented support for a large number of poorly protected non-standard workers. Many of the initiatives to maintain existing jobs (such as short-time working schemes) or strengthen protection for job losers (unemployment benefits, re-employment support) in fact mainly helped workers with a relatively favourable labour-market position, while providing little extra benefits for temporary workers or new labour-market entrants. Several countries have strengthened safety-net benefits (Austria, France, Japan, Korea) or have improved access to unemployment insurance for non-standard workers (*e.g.*, Slovenia), while Italy, where benefit coverage is low, has postponed the reform of financial protection for the unemployed. In general, "dual" labour markets, with a core of well-protected workers and a growing number of unstable jobs at the margin, remain a fundamental issue in delivering and financing effective social protection. The vulnerable position of non-standard workers became indeed much more visible in the aftermath of the crisis. This was especially the case in Japan, Spain and some other countries where labour-market reforms prior to the crisis had primarily increased labour-market flexibility for non-standard workers, while largely retaining protective measures in place for permanent workers. Spain has since announced a labour market reform which aims to address some of these issues. The Japanese government is seeking to introduce measures that focus on protecting non-standard workers.

Figure 9. Changes to redistribution policies since the onset of the crisis



Notes: Policy changes since mid-2008 that were still in place by mid-2010-. Comparisons are made relative to pre-crisis policy parameters and not relative to pre-crisis plans (so crisis-related cancellations or delays of planned reforms are not counted). The chart does not distinguish between measures that are strictly crisis-related and those that are not. It therefore includes some policy measures that were planned or decided before the crisis.

Changes in benefit amounts are only included if they exceed 5% of the 2008 value (beyond that, the chart does not show how much "more generous" or "less generous" provisions have become). Countries are counted twice if some aspects became more and others less generous.

Bars are for all countries, while "+" and "-" markers show changes for specific country groups as follows::

High employment loss, based on expected changes in employment-to-population ratios between 2007 and 2011: Denmark, Estonia, Greece, Hungary, Iceland, Ireland, Portugal, Spain, United States.

High child poverty, with child poverty rates exceeding 15% in the mid-2000s: Canada, Germany, Ireland, Italy, Mexico, New Zealand, Poland, Portugal, Spain, Turkey, United States.

High pension spending, with pension expenditure exceeding 9% of GDP in 2007: Austria, France, Germany, Greece, Hungary, Italy, Poland, Portugal, Slovenia.

Large revenue decline, based on changes in the real value of total government receipts between 2007 and 2009: Australia, Canada, Greece, Iceland, Israel, Ireland, New Zealand, Portugal, Spain, Sweden, United Kingdom, United States.

Sources: Country responses to OECD questionnaires. Country groupings use information from the OECD Economic Outlook, Income Distribution and Social Expenditure databases.

5. Policy priorities for supporting the recovery of households and government budgets

Since the onset of the financial crisis, social policy debates have focussed on the adequacy and affordability of social protection measures designed to contain the downturn's damaging effects on household well-being. Most OECD countries have indeed taken significant steps to cushion income losses for some of the affected groups.

But the challenges are sizable. Public finances of major emerging economies are generally in better shape than in the OECD area, and in around a third of OECD countries, debt-to-GDP ratios were projected to remain below 60% in 2011. But deteriorating public finances in most countries clearly limit the "room for manoeuvre", as they seek to find a balance between fixing government and household budgets. In some countries, the budgetary situation makes rapid and far-reaching consolidation measures unavoidable. At the same time, recessions trigger large losses for some of the poorest income groups – a particular concern since the recent recession came on the heels of a medium-term trend toward greater inequality. There is therefore a greater demand for income support. Moreover, trends following previous recessions suggest that the sizable income losses of disadvantaged households can persist until well into the next economic upswing.

This paper suggests four main policy priorities for addressing these challenges and supporting a recovery of households as well as government budgets.

1. Balanced budget consolidation involving measures on the expenditure and the revenue side

The fiscal or budget crisis is not just a spending crisis. Recessions cause a slump in a range of important revenue sources and a possibility of extended periods of sluggish revenue growth. After the crisis, reduced government revenues have therefore often had a greater impact on the budget balance than inflated benefit expenditures. In most OECD countries, a return to 2007 levels of transfer spending would have closed less than a third of the budget gap in 2010. And, unsurprisingly, no OECD country has been able to achieve cuts of this scale in the context of weak growth and elevated unemployment. Revenue-side measures therefore have an important role. Importantly, historical income trends signal sizable shifts in the relative "tax capacity" from lower to higher-earning groups in the aftermath of steep downturns. Governments should account for this when designing tax measures that seek to balance revenue needs with distributional concerns. Like expenditure cuts, tax measures have to be carefully designed and targeted so as to avoid choking off a fragile economic recovery. Moreover, revenue requirements are such that tax increases in any one area are unlikely to be sufficient for closing the revenue gap. Governments will therefore need to consider a range of measures.

2. Savings measures that address structural affordability problems, including in politically sensitive areas

There are good reasons for prioritising some areas of social expenditure over others. Yet all major spending items must be reviewed to yield short-term savings, including politically sensitive areas such as disability or early retirement benefits as well as old-age pensions.

Previous recessions have shown that programmes leading to early withdrawal from the labour market (early retirement or quasi-retirement payments, disability benefits) create large and practically irreversible increases in social expenditure. While often politically difficult, tightening the availability and generosity of these payments is an effective way of reducing social expenditures now and contributing to safeguarding future fiscal sustainability in the face of ageing populations and workforces.

Old-age cash benefits account for 17 percent of all government expenditure in the average OECD country, and more than one fourth in some of them. Because spending on old-age benefits reflects long-term financial commitments and entitlements, it tends to be much less cyclical than expenditures supporting working-age individuals and their families. But if support for the elderly (or the tax treatment of pensions) contributes little to budget consolidation, this implies greater cuts for working-age individuals, which is the group who is already bearing the majority of crisis-related income losses. While reforms to retirement-income systems quite rightly focus on long-term financial sustainability, short-term changes might help to spread the burden of fiscal adjustment more equally across income and age groups. In principle, this approach would be best suited to countries where public pensions are relatively high (and so retirees were not significantly affected by the financial crisis), and where savings measures can be implemented in a way that does not risk increasing old-age poverty.

3. Adequate protection for the most vulnerable

Nine OECD countries were indeed planning to cut 2011 spending on social transfers in real terms, most of them in the context of persistently high unemployment and weak growth. It is very difficult to cut social expenditures without increasing inequality, and historical data on income trends underline the importance of well-targeted government transfers during economic slumps, as well as during the recovery.

On both the tax side and the benefit side, targeted measures can make fiscal consolidation more equitable. 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 tax measures, including tackling tax avoidance or evasion among higher-income groups, would also generate revenues while strengthening redistribution. Some forms of targeting, such as means-testing, can damage incentives and impose economic costs. But targeting on *behaviour* or *non-income characteristics* can produce cost savings, while leaving incentives intact (*e.g.*, making conditioning benefits more tightly on claimants' active job-search to prevent long-term benefit dependency).

One priority area are measures that safeguard child well-being. While contemporaneous poverty is of concern in itself, the adverse long-term consequences of child poverty are well documented. These "scarring" effects of low-income spells mean that when the recession ends, its impacts on children do not. The provision of adequate, uninterrupted and active support for the least well-off is therefore a central and critical element of social protection, especially at a time of elevated poverty risks. Public services can be an integral part of carefully balanced support for vulnerable groups, including children, as they can make access to important aspects of life less income-dependent. As a result, service cuts can be a particular concern when a large number of people cannot afford market-based services.

4. Investing in well-designed active *social policies*

Redistribution strategies based on government transfers alone would be neither financially sustainable, nor effective at reversing the large income losses that vulnerable households have suffered as a result of the downturn. Employment and earnings growth is essential both for reducing benefit spending, and for shoring up government revenues now and in the longer term. In restoring incomes at the bottom, a key challenge for social and labour-market policy is to facilitate employment and earnings growth that benefits low-income groups in particular.

For households affected by income losses, prospects for finding alternative earnings opportunities will improve as a recovery takes hold. Clearly, for some households, this will be harder than for others, and consumption smoothing is more difficult for low-income households who are therefore more dependent on government transfers. But evidence shows that a large number of new jobs are created even in the depths of a recession. There is a strong case for designing government support in ways that harness and complement – rather than replace – households' own capacities to adjust to adverse circumstances. For instance, several countries that invested heavily in active labour market policies already *before* the crisis were successful at limiting its adverse impact on employment levels. The high fiscal cost of joblessness reinforces the case for well-funded active social policies, even if these are costly in the short term. But fiscal constraints may require a rapid transition from broad, stimulus-type programmes to selective and customised employment support. The best combination of policies will depend on labour market conditions as well. For instance, as the recovery gains momentum and promoting labour supply becomes more important, the focus of active labour-market policies should shift from labour-demand support towards in-work support for low-income working families.

To date, policy responses to the crisis have mostly concentrated on individual job losses and less on the situation of households and families. To be as effective as possible, work-related support should not be restricted to individual job losers, but directed at non-working partners as well. Households where both partners engage in active job search are better able to minimise income losses, and are also in a better position to benefit quickly from an improving labour market. Indeed, women’s working hours have increased, or have fallen less than for men in most countries. Policies should support the increased participation of women by addressing gender-specific employment barriers. With the right policies in place, the current momentum towards a more equal sharing of market work in the household implies that an economic recovery presents a distinct opportunity for making progress on the gender-equality agenda.