Society at a Glance 2014
OECD Social Indicators

Chapter 1

The crisis and its aftermath: A "stress test" for societies and for social policies

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.

Introduction

Social issues lie at the heart of governments' policy agendas. Before the onset of the financial and economic crisis in 2007-08, social spending across the OECD area accounted for about half of all government outlay. But while there is great demand for social protection and support in all phases of the economic cycle, the need is especially acute during and after deep and extended economic downturns. The recent global economic crisis is no exception, as it quickly translated into hardships for households, who suffered unprecedented losses of jobs, earnings, and wealth.

A primary purpose of social policies is precisely to help individuals and families cope with the consequences of economic shocks like the Great Recession and to prevent temporary economic problems from turning into long-term disadvantage. They should enable individuals and families to manage risks more effectively and take better advantage of opportunities. Economic shocks have multiple causes which social policies cannot prevent. They can, however, strengthen families' ability to adapt and respond to economic difficulties when they do occur. Income transfers, health care, and other public services make major shocks both less likely and less damaging. For society as a whole, social policies can prevent cyclical or temporary downturns from turning into protracted social crises.

Against that background, this chapter and the indicators in the rest of the book (see Box 1.1) take stock of what is currently known about the social challenges that have emerged since the onset of the crisis and about countries' policy responses to those challenges. The book considers and discusses the most recent data on the social situation in OECD countries and in selected emerging economies. The aim of this chapter is to address the following three main sets of questions:

- **Are the on-going financial, economic, and fiscal crises leading to a social crisis?** How have social outcomes evolved in the aftermath of the global economic downturn? To answer those questions, Section 1 of this chapter goes beyond economic "headline" indicators – such as unemployment rates, incomes or GDP – that are commonly used as shorthand for characterising and comparing the impacts of the crisis on individuals and families. As important as these aggregate indicators are, they account only very partially for the realities faced by individuals and families during and after a major downturn. The costs of recessions manifest themselves in a multitude of different ways. Deep economic crises can be expected to have profound knock-on effects on people's living arrangements, family formation, fertility, health, career choices, or trust in others and in institutions. Understanding these is important not only for monitoring societal well-being, but also because social tensions and a shifting social fabric can trigger and drive fundamental social, cultural and political change (Castells et al., 2012).
- **How have governments responded?** Economic crises are characterised not only by worsening well-being, but also by great uncertainty and a search for solutions to acute policy problems. Have social policy responses been effective so far? To what extent have they cushioned the immediate effects of the crisis on households and have they

succeeded in supporting families’ efforts to adapt and respond to the resulting challenges? Economic difficulties put families under significant strain as they seek to contain, offset or adapt to insecure job prospects, the loss of earnings or wealth, precarious housing situations, or to waning public support. Section 2 of this chapter maps the evolution of social policies in OECD countries over the last five years and discusses their likely impact in the context of high and increasingly persistent social risks.

- **Can governments make social policies more crisis-ready and crisis-proof?** Specifically, what are barriers to an effective social policy response and how could they be overcome? The cross-country analysis in Section 2 reveals wide differences in the types and scale of countries’ social policy responses. Such differences are also visible between countries who suffered economic shocks of similar magnitudes. It is not surprising, then, that some have been more successful than others in containing the social and human costs of the downturn. The third and final section seeks to identify factors that could explain why some countries have been able to provide adequate, timely help to families hit hard by the economic crisis. It then calls for a number of concrete measures that governments could take to enable more effective social policy responses to future economic crises.

Box 1.1. **About the social and economic indicators in this chapter**

OECD social and economic indicators are widely referred to throughout this chapter – particularly in Sections 1 and 2. They consist of an indicator name and appear in brackets after and in support of a statement or assertion. An example might be: “Female employment rates have risen steadily in the last decade across the OECD” (Chapter 4 “Employment”).

The sentence does two things:

1. It tells the reader that the statement takes its evidence from the data presented in the data chapters of this edition of *Society at a Glance* (Chapters 3 to 7).
2. It refers the reader to the “Employment” indicator. Each indicator includes details on country differences and trends in employment, as well as relevant sources and definitions.

The electronic version of this book features references in hyperlink format that take readers directly to the relevant indicator.

1. Social outcomes in the wake of the economic crisis

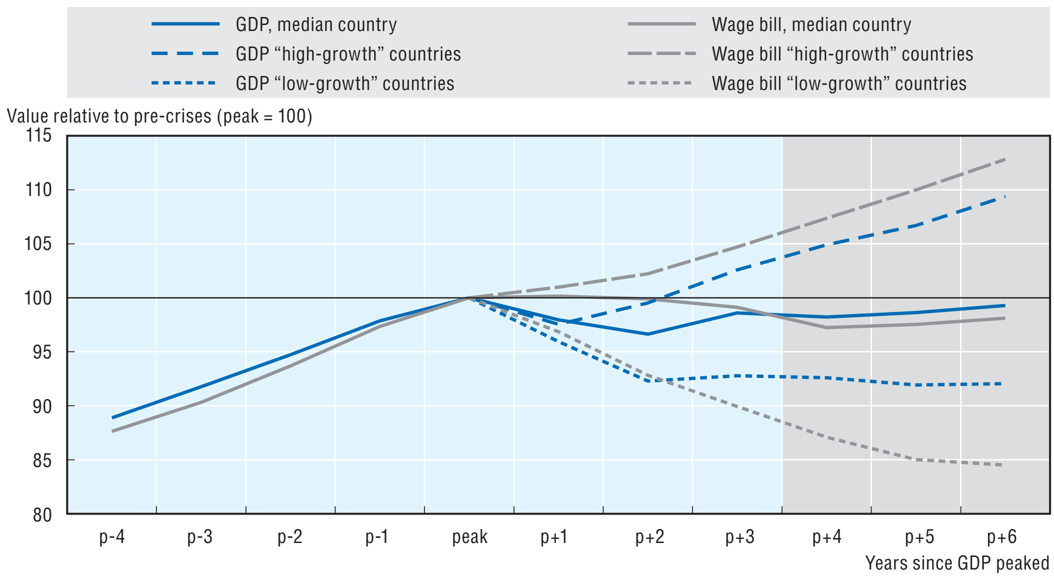
Economic losses heighten social risks

The financial crisis in 2007-08 saw a fast, far-reaching deterioration in economic output for the OECD area as a whole and GDP fell steeply from its pre-recession peaks. But while in some countries, the Great Recession was followed by a moderate but continuous recovery, others avoided outright recession. A number of hard-hit countries, notably in Europe, faced a second recession in 2011-12 and output only began to stabilise in late 2013 (Figure 1.1). More than five years after the Great Recession started, economic output in the OECD is still not back to pre-crisis levels.

Of all the economic losses, however, the income drops suffered by workers have turned out to be the most difficult to reverse. In most countries, the recovery has not yet translated into significant improvements in labour market conditions. Employment and wages have continued to fall until recently (Figure 1.1).

Figure 1.1. **Economic output has begun a recovery everywhere, but employment and wages have not**

GDP and total wage bill in real terms, business cycle peak=100



Note: All data are annual and all changes are in real terms. To focus on the effects of the Great Recession, the graph shows OECD countries that saw a drop in annual GDP at least once between 2007 and 2009. Australia, Korea and Poland are therefore excluded. Israel, Mexico, Turkey are also excluded as data on employee compensation are not available. "Peak" refers to the year with the highest GDP prior to the recession (either 2007 or 2008). The shaded area refers to the periods for which data are projected rather than recorded. "Low-growth" ("high-growth") countries are those where GDP growth between peak and p+4 is below (above) the country average minus (plus) 0.5 standard deviations.
"Low-growth" countries: Estonia, Greece, Hungary, Iceland, Ireland, Italy, Slovenia, Spain.
"High-growth" countries: Austria, Canada, Chile, Germany, New Zealand, Norway, the Slovak Republic, Sweden, Switzerland.
Source: OECD (2013), *OECD Economic Outlook 2013*, No. 93, *www.oecd.org/economy/outlook/economicoutlook.htm* and *http://dx.doi.org/10.1787/data-00655-en*.

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In the worst-affected countries, labour income – households' most important income source – keeps on falling, in some instances at a gathering pace, even as GDP stabilises. Most countries have experienced "jobless" recoveries and/or falling wages and it will take several more years for labour incomes to regain their pre-crisis levels. Where the erosion of earnings persists, consumers are unlikely to play much of a role in supporting an economic recovery.

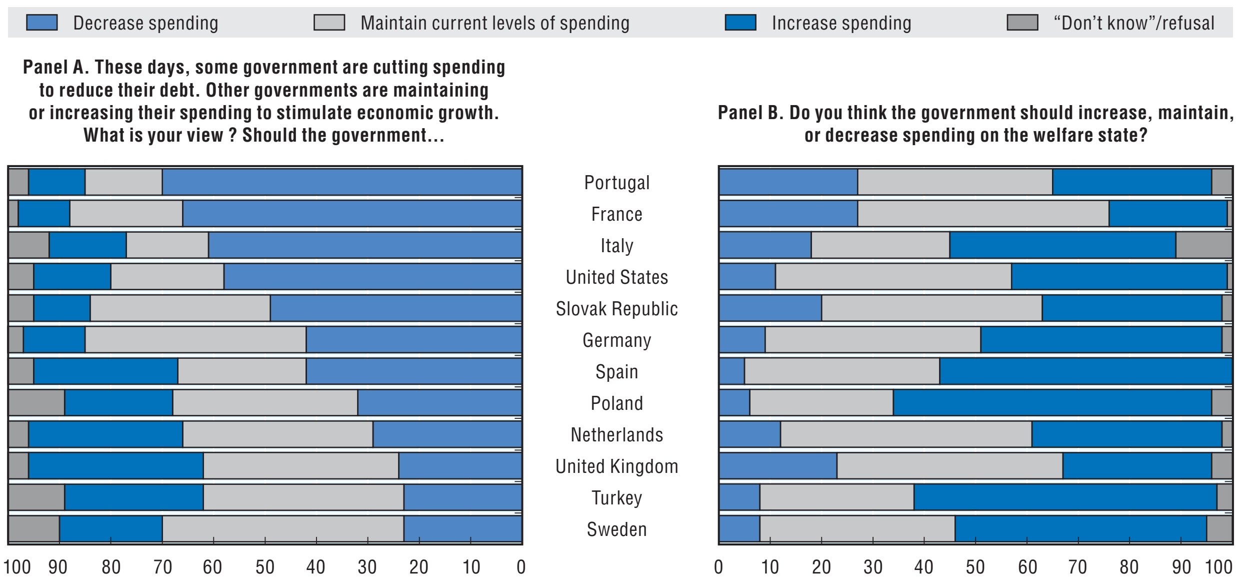
The Great Recession thus continues to cast a particularly long shadow on workers and their families. To policy makers, the negative trends it has generated point to continuing economic hardship, a high risk of growing poverty, and a persistently strong demand for effective support.

The demand for social support has persisted despite a public awareness that something needs to be done about often-unprecedented debt levels and structural fiscal deficits. Figure 1.2 for instance, illustrates the findings from a 2013 survey which shows how, in some countries, attitudes have shifted markedly against government debt and in favour of spending cuts.

Most respondents in France, Italy, Portugal, and the United States supported lowering government expenditure, while in other countries – like the Netherlands, Poland, Sweden, Turkey, and the United Kingdom – people appear much less convinced that spending cuts should be a priority.[1] Strikingly, though, large majorities support protecting or extending social spending, even in those countries where most people consider overall spending too high. That sentiment highlights the essential role of social support measures during and

Figure 1.2. **Most people want to protect social spending, even where support for reducing fiscal gaps is strong**

Percentages of respondents saying that spending should be increased, maintained, or reduced, 2013



Note: The data are taken from Transatlantic Trends, an annual survey of public opinion by German Marshall Fund of the United States, *Compagnia di San Paolo*, Barrow Cadbury Trust, *Fundação Luso-Americana*, BBVA Foundation, Communitas Foundation, and Swedish Ministry for Foreign Affairs. Polling for the 2013 results took place in June and July by phone interview. In each country, the sample consists of approximately 1 000 randomly chosen men and women of 18 years of age and older. The 95% confidence interval attributable to sampling and other random effects is no more than plus or minus 3 percentage points.

Source: GMF (2013), *Transatlantic Trends*, German Marshall Fund of the United States.

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after deep economic downturns. However, concerns about the fiscal situation in some countries also underline the need for cost-efficient social protection and for the difficult task of "doing more with less".

Social risks are higher when hardship is concentrated in specific groups

Effective, efficient social support measures should be properly targeted and tailored to individual circumstances. To that end, understanding the distributional aspects of recessions is essential. The worsening of aggregate income and employment trends is striking and highlights the scale of the crisis. But aggregate numbers hide wide disparities across population groups and regions within countries. By averaging across diverse populations, they understate the difficulties faced by the worst-off.

Deep recessions do not strike symmetrically. Jobs in sectors that bore the brunt of the initial economic slump in the Great Recession, such as financial services, construction, and manufacturing, were particularly exposed. As reduced incomes and depressed product demand permeated the economy, more and more families were affected, even though the extent and duration of difficulties varied dramatically from one group to another.

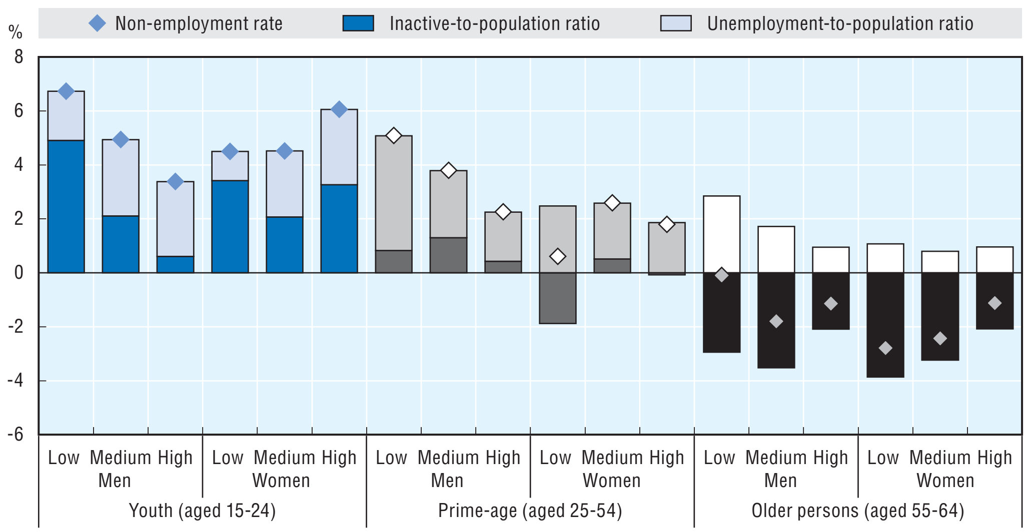
Men, youth, and low-skilled workers in labour-market plight

Since 2007, non-employment rates have increased much more markedly among young people, men, and low-skilled workers than among women and older workers (Figure 1.3). The surge in non-employment, especially among youth and men, reflects a combination of increasing numbers of unemployed (those looking for jobs) and so-called labour-market inactive (including discouraged jobseekers who are no longer available for work or not actively looking).

Figure 1.3. **Employment perspectives of youth and low-skilled deteriorated sharply during the crisis**

Change in the shares of people without work, by age group, sex and education level

Weighted OECD average, Q4 2007-Q4 2012, in percentage points



Note: "Low", "medium" and "high" refer to less than upper secondary, upper secondary, and tertiary education. OECD average refers to Austria, Belgium, Canada, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Luxembourg, Mexico, the Netherlands, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States.

Source: OECD (2013), *OECD Employment Outlook, www.oecd.org/employment/outlook*. See also Chapter 4 "Employment" and Chapter 4 "Unemployment".

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Most affected by rising unemployment are low-skilled prime-age workers (Chapter 4 "Unemployment"), while the doubling of the number of long-term unemployed in the OECD area to 17 million – one in every three jobless people – by the second quarter of 2013 is particularly worrying. Growing numbers of people without recent work experience, depreciating skills, and employers' reluctance to hire them, swell the ranks of discouraged job seekers, i.e. those who want to work but no longer actively look for a job. Lengthening jobless spells make turning a hesitant recovery into a job-rich economic upswing much more difficult, and can lead to rising structural unemployment.[2]

Women and older workers have fared somewhat better: their labour market participation had risen prior to the crisis and has mostly continued to do so. They were also less affected by unemployment. Women, for example, are typically overrepresented in the services and public sector that initially suffered less than male-dominated industries like manufacturing and construction. In addition, many inactive women resumed or entered work in an attempt to offset other household members' loss of earnings. (This so-called "added worker" effect is discussed in detail in Section 3.) Although the crisis had a less adverse effect on the employment situation of women, it spelled the end of the long-term upward trend in employment rates in OECD countries (Chapter 4 "Employment").

The collapse in young people's employment opportunities is of particular concern because it leads to "scarring" – a term commonly used to describe how early working life difficulties can jeopardise long-term career paths and future earnings prospects.[3] The share of youth not in employment, education or training (the so-called "NEETs") has gone up significantly in the OECD area since the onset of the crisis. By late 2012, it stood at 20% or more in Greece, Italy, Mexico, Spain and Turkey (Chapter 4 "NEETs"). The sharpest increases were recorded in countries hardest hit by the crisis (Estonia, Greece, Ireland, Portugal, and Spain) and in Italy, Luxembourg, and Slovenia. In the OECD area as a whole, the number of unemployed youth increased by some two million, with young men accounting for the bulk of the rise.

Public sector workers have initially fared better, despite consolidation efforts

Governments plan fiscal savings in a wide range of policy domains (see Figure 1.6). The wage bill for general government employees in the average OECD country accounts for a large share of government expenditures (around 23% on average across the OECD).[4] As a result, expenditure cuts across all functions of government have often included reductions in staff levels, pay or employee benefits; clearly, public-sector workers are not impervious to the general weakening of the labour market.

At the same time, however, an economic crisis translates into greater demand for social services and other types of labour-intensive public support (e.g. training, education, job-search assistance, and health care). Like other areas of government spending, such services are affected by the conflict that an economic and fiscal crisis generates between a greater need for public support and the reduced fiscal space for financing it. Large drops in staff levels, in particular, may compromise the capacity and quality of social support services (see Section 3).

Figure 1.4 illustrates how general government employment has indeed declined substantially in a number of countries such as Sweden, Italy, and the Slovak Republic. Yet, up to 2011, most countries had safeguarded their public sector jobs more effectively than those in the rest of the economy. Some – like Ireland, Spain, and Slovenia – had actually increased staff levels significantly compared with 2006. However, the latest available international data relate to 2011 and the changes depicted in Figure 1.4 reflect neither governments' more recent spending cuts nor their future consolidation plans.

Individual employment losses leave rising numbers of households with no labour income

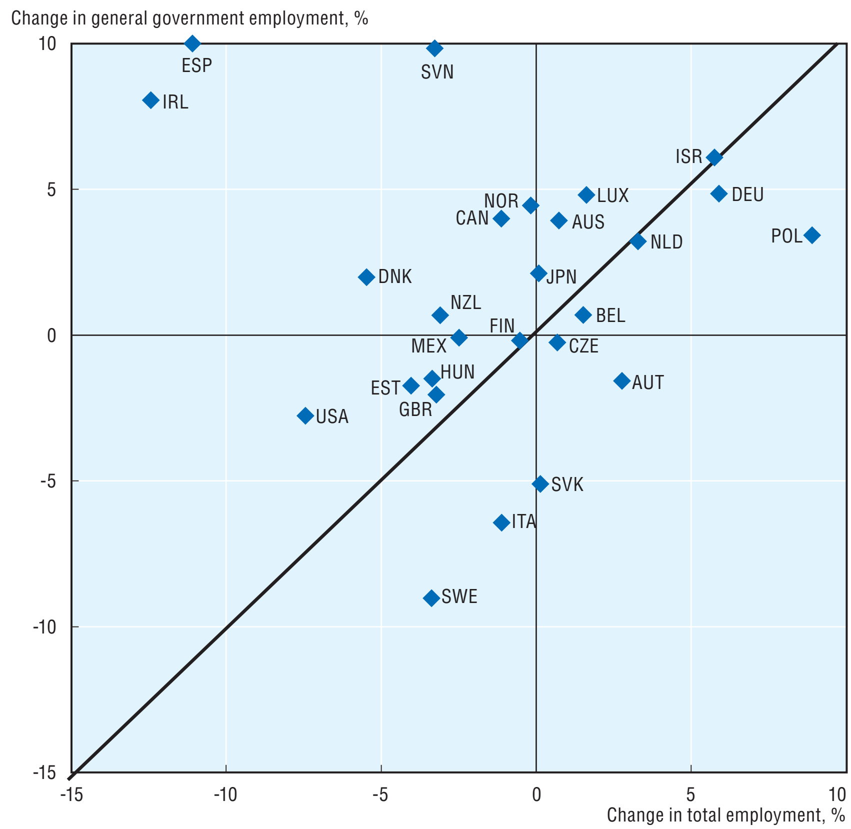
The most commonly used statistics of labour-market difficulties refer to individuals rather than households. They therefore do not show how these individual labour-market problems translate into predicaments at the family level. Since 2007 the proportion of people living in households with no income from work has gone up in most countries, approximately doubling in Greece, Ireland and Spain and increasing by 20% or more in Estonia, Italy, Latvia, Portugal, Slovenia, the United States (Figure 1.5). In debates on fiscal consolidation and other policy reforms, such households deserve special attention as they are particularly vulnerable and highly dependent on government support. With more than one in eight working-age individuals in most countries now living in workless households, the success of redistribution measures and active social policies is gauged to a large extent on whether they can improve economic security for families without any income from work.

Job losses concentrated in economically fragile regions

Geographic concentrations of labour-market disadvantage can threaten social cohesion. They also make it more difficult for governments to respond effectively because they pose greater challenges and because the more economically fragile regions are less able to raise adequate revenue. Regional disparities in unemployment were already high before the crisis (OECD, 2013e). In countries where the unemployment rate has mounted substantially since then, the rise in economically fragile regions has tended to be at least as bad as in the country as a whole. In other words, a large proportion of the increase in unemployment has affected regions where it was above average even before the crisis.

Figure 1.4. **Public-sector jobs were often more secure despite consolidation efforts**

Changes in the shares of working-age individuals in general government jobs and in total employment 2006-11, in percentages



Note: Individuals aged 15 to 64 years old. At the time of writing, 2006 and 2011 are the most recent pre-crisis and post-crisis data on public employment.

Complete or recent data are unavailable for a number of OECD countries (Chile, France, Greece, Iceland, Korea, Portugal, South Africa, Switzerland, Turkey) and are therefore not shown. Data for Australia and Chile refer to the entire public sector (general government and public corporations). Data for Austria, the Czech Republic, Italy, the Netherlands and New Zealand are expressed in full-time equivalents rather than staff headcounts. Data for Germany, Ireland, Norway, Sweden, the United Kingdom are for 2010, not 2011. Data for Hungary, Japan, Mexico, Brazil and the Russian Federation are for 2009, not 2011.

Source: OECD calculations using *ILO LABORSTA Database* (public employment) and *OECD Labour Force Statistics* (total employment).

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Economic hardship felt most acutely among low income earners and youth

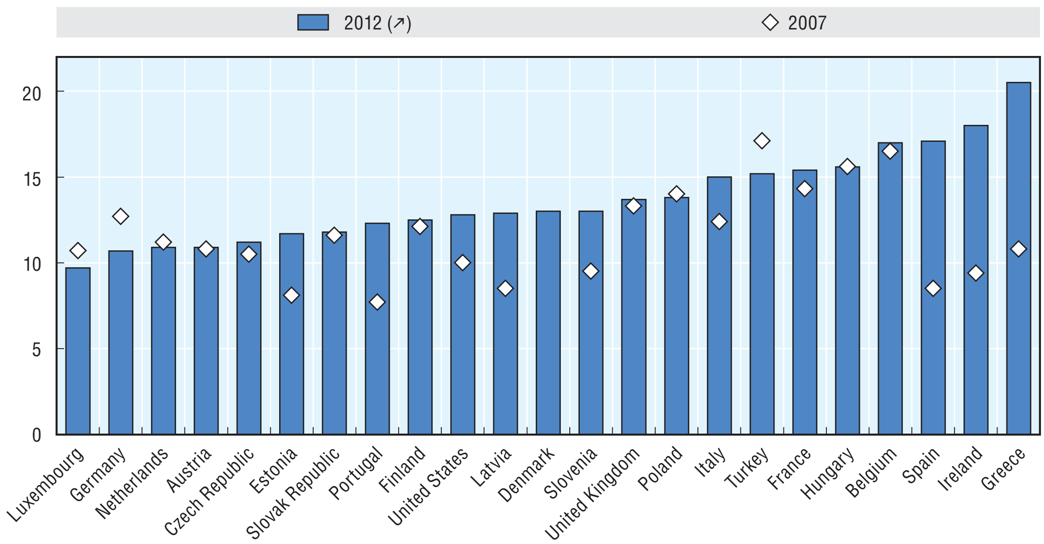
The social impact of the crisis is reflected in the growing numbers of people who struggle to meet their basic needs. According to data from the Gallup World Poll, one in four respondents in the OECD area reported income difficulties in 2012, with the proportion climbing to three out of four in Hungary and Greece and one in two in the United States. The incidence of reported trouble in making ends meet has been on the rise since 2007 in 26 countries, including some where social safety nets have played an important role in cushioning the impact of the crisis (e.g. the Nordic countries, France, and Germany).

Objective measures of household income show both that subjectively reported difficulties are real and that – once again – the burden of income losses has not been evenly shared (Chapter 3 "Household income" and Chapter 5 "Income inequality").

At the onset of the crisis, falling capital incomes lowered top incomes while stimulus packages, along with often powerful automatic stabilisers, helped ease the pain of income

Figure 1.5. **Very large increases in the number of workless households are a major test for social policies**

Shares of adults living in workless households, in percentages



Note: Households are defined as "workless" if all household members are either unemployed or labour-market inactive. "Adults" refers to individuals aged 15-64. Data for the United States are for 2013, not 2012.
Source: OECD estimates based on the European Union Labour Force Survey and the United States Current Population Survey.

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losses at the lower end of the income distribution. As adverse economic conditions have persisted, however, lower income households have lost greater proportions of their incomes than the better-off or benefited less from the sluggish recovery – particularly in the hardest hit countries like Estonia, Greece, Ireland, Italy, and Spain, though not in Iceland where well-off households have sustained greater income losses than poor ones.

Across the OECD, the average income of the total population stagnated between 2007 and 2010, while that of the bottom 10% fell at an *annual* rate of 2%. Clearly, the crisis has worsened longer-term trends of rising income inequality (OECD, 2011), a finding that national studies have confirmed.[5] More recent aggregate data from OECD national accounts and from national studies using household surveys (such as Cribb et al., 2013 on the United Kingdom) also show that total household incomes often continued to fall after 2010. As social spending comes under pressure from fiscal consolidation, there is a risk that incomes will continue to deteriorate for families with incomes below or close to the poverty line.

Measuring poverty against a *relative* poverty line (Chapter 5 "Poverty") suggests that, between 2007 and 2010, the average share of the poor in OECD countries grew only marginally, by 0.1 percentage points to 12%.[6] One reason was that social benefits softened the impact of the crisis. But these commonly used relative poverty measures can be difficult to interpret in times of rapid economic change because the poverty line, which is expressed as a percentage of incomes in middle-class households, also moves. Even if those at the bottom of the income ladder suffer significant losses during a downturn, measured poverty might not increase when the average income – and thus the poverty line – falls as well, as often happens during a recession. A more direct way to measure losses at the bottom of the distribution is to take a poverty threshold "anchored" in a given year as the benchmark. This approach reveals a much steeper increase in poverty rates during the first three years of the crisis – as much as two percentage points or more in countries like Greece, Ireland, and Spain.

Thus, even before the bulk of fiscal consolidation programmes kicked in, half of all OECD countries were failing to hold back the rising tide in market income inequality and its impact on those living on incomes at or below the poverty line. However poverty is measured, growing economic hardship at the bottom of the income distribution is unlikely to be a mere "statistical" particularity, where some people shuttle from just above to just below poverty thresholds. Indeed, OECD income distribution data (not reported), together with results from national studies (such as Shaefer and Edin, 2013, for the United States), show that higher poverty rates were frequently accompanied by deepening poverty – a widening gap between families' incomes and the poverty line.

In a majority of OECD countries, young adults and families with children face considerably higher risks of poverty today than in 2007 (Chapter 5 "Poverty"). The share of 18-25 year-olds in households where incomes are less than half the national median income has climbed in the vast majority of OECD countries between 2007 and 2010. Rises have been particularly steep in Estonia, Spain, and Turkey (5 percentage points), Ireland and the United Kingdom (4 points), and Greece and Italy (3 points). Lower-income older people did relatively better, as public pension benefits generally changed little and relative income poverty among the elderly fell in most countries. These changes follow a longer-term trend of falling poverty rates among the elderly. Averaged across OECD countries, the proportion of poor people is now, for the first time, lower among the elderly than among young adults and children.

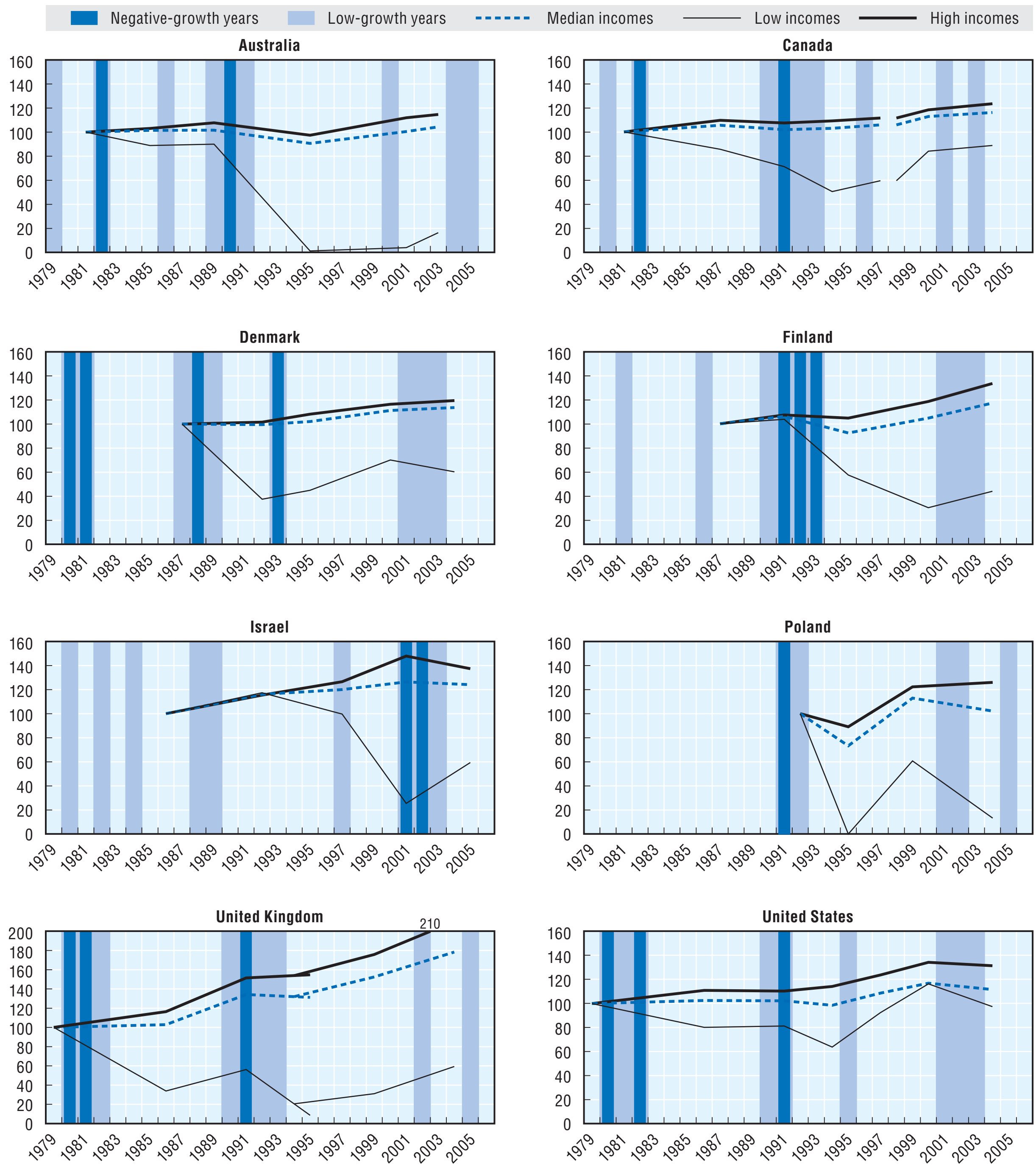
What do these recent trends mean for longer-term inequality trends? Information from earlier downturns provides pointers as to the distributional mechanics which tend to be at work well into the recovery phase. Figure 1.6 offers just such a historical perspective on the income trends among low-, middle- and high-income households across earlier economic cycles. These trends are for *market* incomes, that is, before adding social transfers or subtracting taxes. By focussing on market income, Figure 1.6 indicates the space that redistribution policies have to bridge if they are to stem widening gaps between household incomes after taxes and government transfers. A number of patterns stand out:[7]

- In spite of long periods of significant aggregate economic growth, low-income households saw market incomes decline over the periods shown in Figure 1.6. Joblessness can take market incomes to very low levels if all family members are without work. (When 10% or more of the population live in such households, the 10th percentile point will be close to zero.) Plummeting incomes during periods of rapidly rising joblessness were, for instance, observed in the early 1990s following the recessions in Australia and the United Kingdom, and during the economic transition in Poland.
- Among higher-income groups, any disruptions in longer-term upward trends were short-lived during the downturns of the early 1980s and 1990s.
- Market-income inequalities widened in most countries during both downturns and upswings. When incomes at the bottom fell rapidly during and after recessions, incomes in the upper parts of the distribution often continued to rise, albeit at a slower pace. And even where downturns did result in longer-lasting income losses for higher-income groups (as in Australia, Finland and Poland), they nevertheless tended to be smaller than for low earners.
- Any episodes of narrowing income differentials did not usually last long enough to offset the gap between high and low incomes that had opened up in preceding years.

Figure 1.6. **Recessions widen income gaps, and recoveries often fail to close them**

Household market incomes for working-age households at different points in the income distribution

In constant prices. Earliest available data point = 100



Note: Initial income gaps between "low" and "high" incomes differ from country to country. Comparisons of the gaps should therefore be made over time, not across countries. Start of series varies due to data availability. Separate series in Canada and the United Kingdom indicate a break due to changing underlying data sources.

Households headed by a working-age individual aged between 15 and 64. "Low" and "high" incomes refer to the 10th (15th in the United Kingdom) and 90th percentiles of the distribution of household market incomes. "Low-growth years" are the bottom third years in terms of real growth between 1979 and 2005 in each country.

Household incomes are market incomes (government transfers are not added and taxes are not subtracted) and account for differences in household size (they are divided by the square root of the household size).

Source: Immervoll, H. and L. Richardson (2011), "Redistribution Policy and Inequality Reduction in OECD Countries: What Has Changed in Two Decades?", *OECD Social, Employment and Migration Working Paper*, No. 122, OECD Publishing, Paris, *www.oecd.org/els/workingpapers*; *OECD Economic Outlook: Statistics and Projections* for annual growth data, *http://dx.doi.org/10.1787/data-00655-en*.

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- These historical trends point in similar directions as data available for the most recent downturn (Cribb et al., 2013; Hoynes et al., 2012). For instance, Hoynes et al. show that, as in earlier recessions, those who are unemployed or in unstable jobs even in good times are, yet again, the main losers in the Great Recession. As they put it with reference to the distribution of jobs and earnings losses, "the Great Recession is different from [earlier] business cycles (…) in size and length, but not in type".

Economic hardship carries serious consequences for families and society as a whole

Economic hardship has a highly tangible impact on well-being and, when they can, households actively adapt to these adverse circumstances. Some types of responses, such as drawing down savings or reducing non-essential consumption, limit negative long-term effects of income losses. But severe, long-lasting economic travails can overwhelm families' capacity to adapt effectively. Unless there is sufficient public support, they may be forced to cut down on essential consumption, such as food, shelter, and health care. They may also have to curtail investment in their future well-being by, for example, interrupting or cutting short education or training.

Poor households with little savings are more likely to have to resort to coping strategies that are damaging in the long term. Social support measures and policies that ensure adequate access to credit are essential to such households, enabling them to "push through" temporary low-income spells.

Good-quality education may become less affordable as governments spend less

Weak labour markets can make staying on in education a more attractive prospect: opportunity costs – immediate foregone earnings – are lower, which can translate into higher educational attainment (OECD, 2013a; Holzer and Dunlop, 2013).

A good education is expensive, however, and lower wealth, incomes, and profits may affect people's ability and readiness to invest in education and training (Lovenheim, 2011). To compound matters, fiscal restraint inhibits the provision of the additional resources needed to absorb greater student numbers and maintain quality (Barr and Turner, 2013). Indeed, consolidation efforts halted the long-term trend of rising public spending on education: it declined relative to GDP between 2009 and 2010 in more than half of OECD countries, with cuts especially sharp in Hungary, Iceland, Italy, Sweden, Switzerland, and the United States (Chapter 4 "Education spending"). Such reductions in public spending are likely to make good-quality education more costly for lower-income households in particular.

The consequences of lower public spending on education will take time to materialise, be it in the form of lower student participation, poorer outcomes, or reduced upwards mobility for children of low-income parents. But, as with cuts in other areas of public investment, it is precisely the longer-term consequences that can be most damaging.

Health outcomes may deteriorate

Difficult economic conditions, people's behavioural responses to them, and health policy changes may all have impacted on people's health. There remains, nevertheless, considerable uncertainty as to the net effects of the crisis in the short- and the longer term. At the aggregate country-wide level, studies that consider such broad measures as mortality often find that recessions exert *positive* short-run effects on health (i.e. mortality is lower). At the same time, there is strong evidence of *negative* effects on individuals most affected by downturns (unemployed working-age people), especially over the long term (Vangool, 2014).

Indeed, the different ways in which people react to economic downturns have sometimes opposite health effects. For instance, reduced economic activity can curb pollution and lower the risk of road traffic accidents – fatalities on the roads have in fact declined in recent years (OECD, 2013h). Lower incomes may also reduce expenditure on alcohol or tobacco in some groups. At the same time, however, economic troubles can lead to increased substance abuse, anxiety, antisocial behaviour, poor diets, and generally less healthy lifestyles (Catalano, 2009).

Reduced spending on food is one of the main causes of food insecurity, a term that describes a situation where inadequate access to food does not allow all members of a household to sustain a healthy lifestyle.[8] In the United States, where the incidence of food insecurity is monitored on a regular basis, rates of food insecurity have soared since 2007 (Coleman-Jensen et al., 2013).

While federal food assistance programmes in the United States now support roughly twice as many households as in 2007, the number with inadequate access to food at some time in the year has nonetheless climbed from 13 million (11% of all households) in 2007 to 17.6 million (15%) in 2012. Rates of food insecurity were substantially higher among households with children (20% in 2012) and lone-parent families were particularly affected (35%). Forty-one percent of all food-insecure households received no support through federal food assistance programmes.

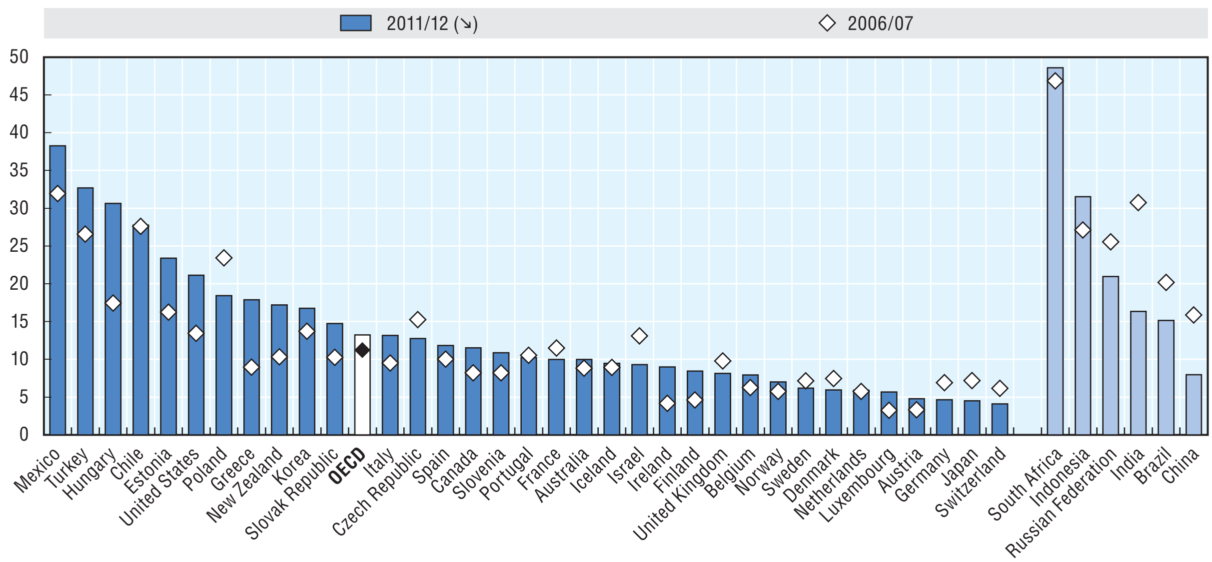
While there are no internationally comparable statistics on food insecurity that are as detailed as those of the United States, some unofficial estimates indicate that growing numbers of families and children suffer from hunger or food insecurity in economically distressed countries. Some 10% of students in Greece fall into that category according to Alderman (2013). The Gallup World Poll includes a question on whether respondents feel that they have "enough money to afford food". Responses confirm that rising numbers of families in OECD countries may have less money to spend on food and a healthy diet. By contrast, while large shares of people in the large emerging economies feel that they cannot afford adequate nutrition, their numbers have mostly declined since 2007 (Figure 1.7).

Another critical risk factor for worsening health is constrained access to health care, particularly among the poorest. Economic downturns may result in lower rates of health care use if more people feel they cannot afford it – when private health insurance is tied to employment, for example. Moreover, in response to deteriorating public finances governments may cut health spending and, by the same token, their health care provisions (Vangool, 2014).

With household budgets under pressure, families have indeed reduced their use of *routine* health care services since the onset of the economic crisis, particularly in countries with high co-pay health insurance plans. For instance, in a survey in the United States, 27% of respondents stated that they had cut back on their use of health care services in 2009 (Lusardi et al., 2010). Similarly, across eleven OECD countries, 15% of respondents said that health costs had stopped them from visiting their doctor, filling prescriptions, and/or having a medical check-up at least once during the previous 12 months (Schoen et al., 2010). For Europe, recent data show that, in all countries, low-income families have above-average "unmet medical needs" (Chapter 6 "Coverage for health care"). And across OECD countries, the share of low-income individuals reporting a "good" or "very good" perceived health status is significantly lower at 61% than the 80% share among high

Figure 1.7. **Growing numbers of people feel they cannot afford food**

Percentage of survey respondents



Note: Share of “yes” responses to the question “Have there been times in the past 12 months when you did not have enough money to buy food that you or your family needed?”.
Results are averaged over a two-year period to minimise the impact of year-on-year fluctuations.
2008 data for Iceland, Luxembourg and China instead of 2006-07; 2009 data for Switzerland (instead of 2011/12).
For measurement details and limitations of the Gallup World Poll, see Chapter 7.
Source: Gallup World Poll, *www.gallup.com/strategicconsulting/en-us/worldpoll.aspx*.

StatLink http://dx.doi.org/10.1787/888932965991

earners (Chapter 6 “Perceived health status”). Such patterns highlight the significant risk of income losses translating into lower utilisation of health care services and, subsequently, into poor health.

Lower or delayed utilisation of *preventive* measures such as breast cancer screening also gives cause for concern as it may lead to additional health risks, greater care needs, and higher spending in the future. Catalano (2003) describes how, during periods of economic stress, the incidence of diagnoses of advanced disease appears to rise. A recent study also finds that a 1% increase in unemployment in the United States is associated with a 1.6% lower use of preventive care facilities (Tefft and Kageleiry, 2013). Poorer individuals, who typically have greater health care needs and are also more likely to cut spending may thus expose themselves to significant risk (Edwards, 2008; Schoen et al., 2011).

Generally speaking, there is overwhelming evidence that long spells of unemployment and joblessness are detrimental to both mental and physical health (OECD, 2008a; Sullivan and von Wachter, 2009). Recent studies of patterns in the prescribing of mental health drugs in the United States suggest that prescriptions rise during recessions (Bradford and Lastrapes, 2013). Even a relatively small rise in unemployment can lead to a substantial increase in the use of drugs. Kozman et al. (2012) report increases of 4% in prescriptions for statins and 3% in PDE inhibitors following a 1% rise in unemployment. In Sweden and Denmark, job loss was found to lead to a higher probability of hospitalisation for alcohol-related conditions, accidents, and mental health problems (Eliason and Storrie, 2009). There also appears to be a close link between the economic crisis and hospital attendance more broadly. For instance, in the United States, Curry and Tekin (2011) and Brooks-Gunn et al. (2013) report an increase in admissions for preventable conditions and the physical abuse of children.

Rise in pre-crisis fertility rates has stalled in several countries

The recovery in fertility rates observed in several OECD countries prior to the crisis now appears to have come to a halt. Up until the early 2000s, fertility in the OECD area dropped dramatically from 3.3 children per woman in the 1960s to 1.63 – significantly below the so-called "replacement level" of 2.1. The subsequent modest rise in total fertility rates (TFRs) to a country average of 1.75 in 2008 was an encouraging development. Since then, however, average TFRs have dropped back – to 1.70 in 2011 – as lower and uncertain incomes may have prompted families to delay parenthood or have fewer children (Chapter 3 "Fertility"). Even tiny variations in fertility rates affect demographics, patterns of population ageing and, consequently, the sustainability of existing social and health provisions.

Fertility levels and past trends, however, vary hugely across countries, with many emerging economies currently seeing a "youth bulge" resulting in large and growing numbers of young people, while populations are ageing in high-income countries. Where populations decline, migration becomes more significant – both as a factor shaping the demographic composition of a country's population, and as a possible mechanism for alleviating trends in populating ageing (Chapter 3 "Migration"). The patterns of crisis exposure and poor economic conditions have altered the dynamics of migration across the OECD area. Australia, Norway, and Switzerland – all countries that were less affected by the crisis – did indeed see an increase in net migration. But migration outflows rose sharply in hard-hit countries such as Estonia, Greece, Spain, Ireland, Italy, Iceland and Portugal. Where young and skilled population groups leave in large numbers, countries face significant additional challenges and the prospect of a worsening demographic outlook and less favourable economic development (OECD, 2013i).

Other social impacts of the crisis are plausible but not always visible in available data

Changes in behaviour or attitudes are a consequence of the strategies that families adopt to cope with economic crises. For instance, although they share resources in all stages of the economic cycle, mutual support becomes vital when economies are weak. Through the support provided by other family members, those affected by job or financial losses thus enjoy greater economic security. However, providing this support places greater demands on family resources, with widespread unemployment or troubled pension investments, for example, prompting a rise in intergenerational support. This pattern is, for instance, documented by studies showing large numbers of unemployed youth returning to the parental home or not moving out in the first place (Morgan et al., 2011 report such a pattern for the United States).

Although the greater need for support may strengthen family ties, economic stress and more acute work-life conflicts can also lead to family breakdown and higher divorce rates. Recent data point to an increase in perceived work-life conflicts (OECD, 2013d) and work pressures resulting from job insecurity and unsocial working hours (McGinnity and Russell, 2013). The net effect of such factors on family bonds and family structure is not clear, however, and may be small (Chapter 3 "Family").

Greater economic hardship and dissatisfaction affect not only family ties but also relationships with and attitudes to fellow citizens and social, economic and political institutions. Such changes in outlook may, in turn, drive patterns of civic engagement and collective action for political reform and societal progress. Conversely, indicators of the degree of acceptance of minorities – e.g. immigrants or individuals with a particular sexual orientation – point to significant drops in tolerance in some countries where the crisis has bitten hard. Greece is a notable example. Currently, however, there is little evidence of a systematic link between intolerance and the economic crisis, which suggests that economic factors are neither the sole nor primary drivers of observed change (Chapter 7 "Tolerance"). Indicators of solidarity, such as charitable donations or voluntary work, also show a significant drop in Greece, while they have risen significantly in other hard-hit countries (Chapter 7 "Helping others").

However, the link between economic difficulties and people's mistrust of national governments appears to be more clear-cut. Such trust declined in most OECD countries from 2007 to 2012, with the largest drops coming in Greece, Ireland, Portugal, and Slovenia. However, young people in Spain and Portugal tended to trust their governments more than their adult counterparts, and their confidence also declined less. There has been a much sharper fall in trust in financial institutions across virtually all OECD countries (Chapter 7 "Confidence in institutions").

Where the crisis has bitten, life satisfaction is now lower than in 2007

Societal well-being is a difficult concept to measure and compare on any one-dimensional scale,[9] be it a traditional metric like GDP or a subjective measure like happiness. As a "satisfactory empirical approximation [of individual utility]" (a phrase used by Frey and Stutzer, 2002), subjective well-being is, however, of considerable interest when assessing the social impact of policy reforms or economic "events" such as the Great Recession.

There have been a number of recent reports of the crisis leading to greater dissatisfaction with life. Some of the most alarming potential symptoms of such a trend relate to rises in suicide rates. A closer look at cross-country data confirms that suicide rates climbed slightly at the onset of crisis in countries such as Ireland, but recent data suggest that the trend has not persisted. Although there was a rise in the number of suicides reported in Greece in 2011 (Liaropoulos, 2012; Karanikolos et al., 2013), the rate stood at one-fourth of the OECD average. Overall suicide rates in the country were stable in 2009 and 2010 despite worsening economic conditions and the changes since then – a rise in 2011 and a drop in 2012 – do not point to any clear trend. Similarly, for the OECD area as a whole, the severe economic crisis does not so far appear to have led to a sharp change in suicide rates (Chapter 6 "Suicide").[10]

However, as argued above, the major health-related and societal problems that a deep economic crisis may trigger are unlikely to materialise immediately. For instance, research shows that there is a reasonably strong longer-term association between life dissatisfaction and higher risks of suicide (Koivumaa et al., 2001). Waning life satisfaction could thus be seen as a *leading indicator* that points to serious health or societal problems developing at a later date.

Across the OECD area, average reported life satisfaction in 2012 was only slightly lower than in 2007 (Chapter 7 "Life satisfaction"). But related data for Europe show that reported well-being declined substantially among groups suffering the biggest deterioration in incomes and labour-market prospects (Eurofound, 2013). There were also sizable fluctuations in the intervening years. In 2008 and 2009, contentedness fell significantly as the scale of the crisis became clear. Then, in 2010, most countries emerged from recession. Life satisfaction climbed before dropping once again in 2011 and 2012 when fiscal problems mounted and recovery turned out to be weaker than hoped. Life satisfaction deteriorated most in Southern Europe (Greece, Italy, Portugal, and Spain), while it improved in countries where the economic impact of the crisis was either less acute or shorter (e.g. Chile, Mexico and, to a lesser extent, Nordic and some Eastern European countries). In the vast majority of OECD countries, however, expectations as to future life satisfaction fell (OECD, 2013d).

Emerging economies were less affected by the crisis, but still face major social challenges

The major emerging economies have made very significant progress towards reducing absolute poverty. Although high inequality and the comparatively low capacity of their social protection systems remain considerable challenges, the economic and social impact of the global downturn was less than in most of the OECD area. The context in which it took place was also significantly different in emerging economies.

Thanks to long periods of strong economic growth, emerging economies have reduced extreme poverty. However, their experience of earlier recessions underscores the need to develop sustainable, "crisis-proof" social protection systems (Box 1.2). Inequality and poverty continue to be daunting policy challenges in emerging economies. Yet their social budgets are smaller than in the OECD area, which leaves many workers and households exposed to economic shocks. The fiscal outlook, while generally much better than in advanced countries, has also become less favourable, due, in part, to higher interest rates and weaker growth prospects (IMF, 2013). In effect, then, OECD and emerging economies must both rise to the challenges of securing adequate resources for their social policies and, where necessary, of "doing more with less".

Box 1.2. **Major emerging economies continue efforts to strengthen redistribution**

In contrast to recent and projected austerity measures in much of the OECD area, the large emerging economies have generally sought to bolster redistribution measures as part of their bid to address concerns over high poverty and inequality. Measures to strengthen social protection should also be seen in the context of strategies to support domestic demand and reduce excessive saving in some countries – particularly in China.

The big emerging countries have drawn on their strong economic growth to reduce extreme and absolute poverty – a direction they have pursued since 2007 despite the slow-down in growth. Yet their poverty-reduction achievements cannot be explained by aggregate growth alone. They also reflect effective redistribution policies, as exemplified by well designed, targeted programmes that help to cushion the impact of economic shocks on the most vulnerable.

Income redistribution is a central pillar of **Brazil**'s growth model. Since the early 1990s, the country has made tremendous progress in lifting millions of people out of poverty and reducing inequality. The *Bolsa Familia* conditional cash transfer has become a prominent model of successful poverty reduction programmes and a benchmark for anti-poverty measures in other countries.

In **India**, where fiscal deficits have been much wider than in other emerging economies, spending on social welfare is skewed towards food and other subsidies and employment in public works schemes. Income transfers play a much more limited role, although recent initiatives seek to convert a number of subsidy programmes into direct cash transfers.

High levels of income inequality and poverty in **South Africa** are, in large part, a reflection of labour-market inactivity and unemployment. Between 2007 and 2011, labour utilisation deteriorated further. However, the introduction of progressive tax measures and the expansion of social transfers since the mid-1990s have strengthened government redistribution.

Box 1.2. **Major emerging economies continue efforts to strengthen redistribution** *(cont.)*

Although inequality is also high in **China**, it reached its peak in 2008. In urban areas, it has trended down for some years, reflecting changing wage patterns and more comprehensive health care reimbursements at the lower end of the income spectrum. The gap between rural and urban incomes has also narrowed as rural migrants send earnings back to the countryside. Within rural areas, though, migration has widened income gaps between families with and without migrant workers.

In **Indonesia**, absolute poverty declined rapidly prior to the Asian financial crisis of the late 1990s, a trend that has continued to this day, albeit at a slower pace. Pro-poor economic growth almost halved the proportion of people living below the national poverty line between 2000 and 2010, reducing it to 13.3%. The policy was, however, accompanied by a significant rise in income inequality, which has also had a powerful effect on the lower part of the income distribution. Overall, Indonesia’s expenditure on poverty reduction schemes remains low: between 2004 and 2010, the country spent approximately 0.5% of GDP on social assistance on average, whereas the average expenditure in other developing countries was some 1.5% (World Bank, 2012).

Selected new policy initiatives

Across emerging economies, there are some bold examples of new policy initiatives and measures to increase the effectiveness of existing social protection measures. Challenges remain, however, as income gaps are often very wide and the effects of structural changes, such as rural-urban migration, can further aggravate them. Reforms have also come up against administrative bottlenecks and challenges which can hamper the effective implementation of social protection measures. Nevertheless there are encouraging examples of well-designed, highly successful programmes.

- In **Brazil**, the poorest 10% of the population enjoyed very fast annual income growth rates in recent decades (comparable with China’s per capita GDP growth), while income gains in the top decile were smaller (closer to per capita GDP growth in Germany). Changes in both labour and non-labour incomes have played equally important roles in sustained inequality reductions. Labour incomes have become more equally distributed as the earnings gaps between high- and low-skilled labour (Brazil’s traditionally very high “education premium”) have narrowed markedly and greater access to education has enabled more households to earn higher wages. At the same time, government transfers have played a crucial role. The *Bolsa Familia* scheme provides cash transfers to low income households that are conditional on school attendance and health check-ups. Recent refinements have further increased the programme’s generosity, effectively lifting all participants whose income was below the national poverty line above that threshold.
- In **India**, the expansion of the national health insurance system for the poor, known by the acronym RSBY, is important and welcome as large out-of-pocket expenses associated with private hospital stays have long been a barrier to health care access. At the same time, increased investment in public health facilities supports the very poor in areas where no other health services exist. The National Rural Employment Guarantee Scheme (NREGS), a workfare scheme rolled out in 2006 and subsequently expanded nationwide, seeks to guarantee a minimum of 100 days of employment at the minimum wage in rural areas. Its main objectives include boosting rural income, stabilising agricultural production, and curbing rural-urban migration by funding small-scale farm and local infrastructure projects. There is, however, no national equivalent for poor urban dwellers, and the quality of programme implementation has been mixed. The government has renewed efforts to further increase food subsidies, to target them more

Box 1.2. **Major emerging economies continue efforts to strengthen redistribution** *(cont.)*

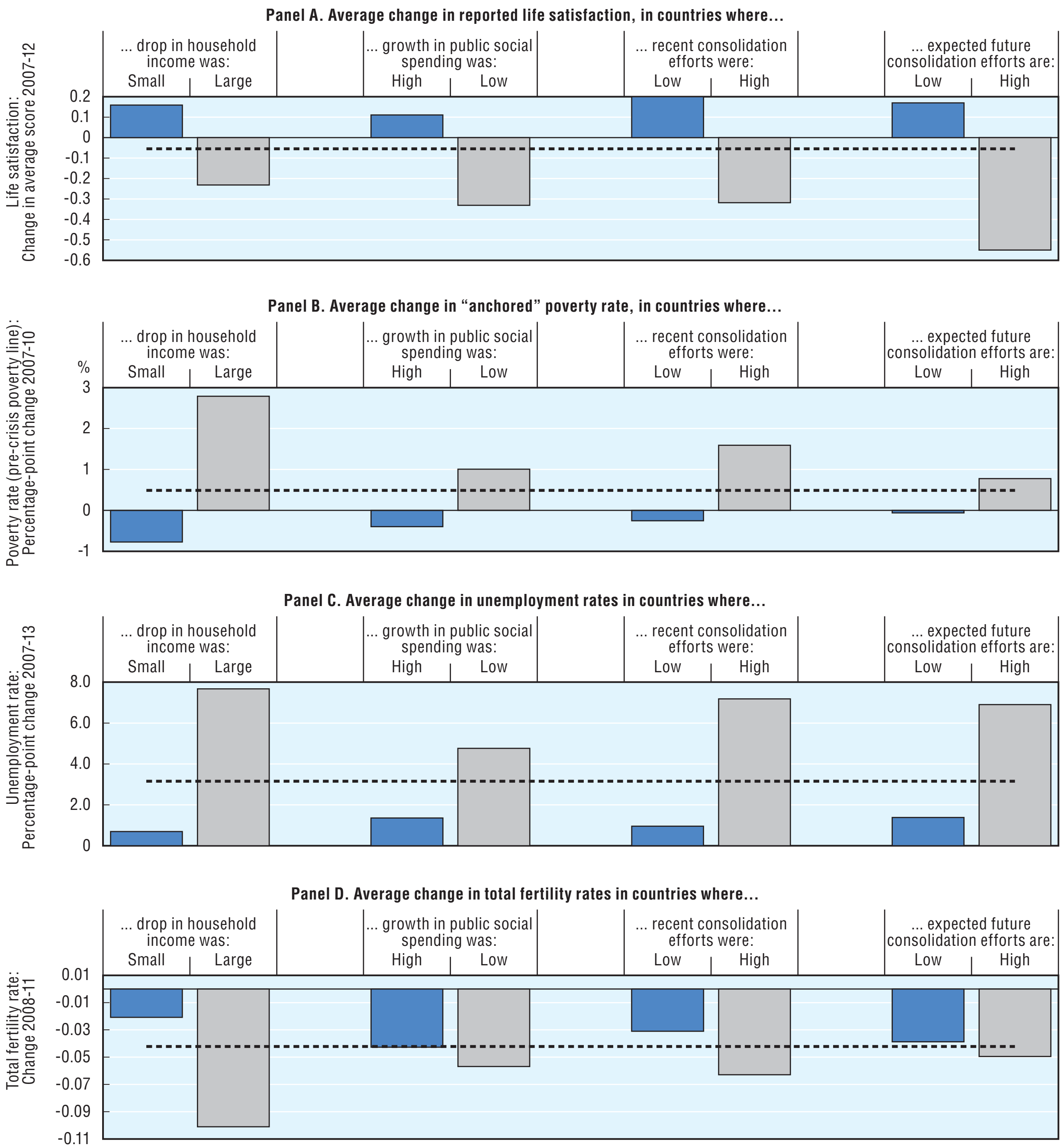
effectively, and to address some of the very costly inefficiencies in the existing distribution of subsidised food. From July 2013, the National Food Security Act (NFSA) provides some 67% of the population with legal rights to five kilogrammes of food grains at highly subsidised prices, and with an equivalent cash allowance if subsidised food is not available or insufficient. NFSA complements existing food programmes run by states and also provides daily free meals for children, pregnant women and lactating mothers.

- **South Africa** has, over recent years, clawed back some 40% of the increase in market-income inequality through its expansion of social transfer schemes. Social assistance now accounts for two thirds of income in the bottom quintile (the poorest 20% of the population). Nevertheless, the reduction of inequality attributable to taxes and transfers remains well below OECD levels. The South African government's two main strategic policy documents – the National Development Plan and the New Growth Path – place much emphasis on measures to increase employment and cut unemployment. At the same time, limited administrative capacity, especially at the sub-national government level, is one stumbling block in efforts to build a more inclusive society. In addition, engaging households with poor literacy in administrative procedures is vexed by information barriers and inefficiencies. Partly as a result social programmes do not reach all intended beneficiaries (for instance, the take-up rate of the Child Support Grant, a comprehensive social assistance programme, is only 60%).
- The **China** State Council issued guidelines in February 2013 designed to encourage further measures to reduce inequality and boost consumption, e.g. by strengthening redistribution through better tax collection and pushing ahead with property taxes. The guidelines also called for increased social expenditure (from 36% of government outlays in 2011 to 38% by 2015) with an emphasis on low-income regions through intergovernmental transfers. As in South Africa, effective implementation at the local level is likely to be critical to effectively functioning redistributive policies, especially in big, expanding urban areas.
- In **Indonesia**, a new era of decentralisation in the wake of the Asian financial crisis in the late 1990s brought significant changes to the country's political structure and social policy strategies. While most centrally managed poverty alleviation policies were universal, decentralisation was accompanied by measures increasingly targeted at helping the poor. In addition to providing resources through social assistance, direct poverty alleviation strategies, such as improved access to health and education, are now much more common. In a culturally, geographically, and economically very diverse country, decentralised intervention strategies have had positive impacts. As in other emerging economies, implementation challenges remain, however, especially in relation to the appropriate targeting of beneficiaries. Dealing with inefficiencies and "leakage" in social assistance is one key policy challenge. Indonesia's expenditure on major poverty reduction programmes remains small. Low spending levels are in part driven by weak tax collection: although they have increased in recent years, tax revenues still account for only 12% of GDP – significantly lower than in other emerging economies.

Symptoms of a social crisis – and the right policy responses

In summary, the evidence considered in this first section of the chapter suggests that the financial upheaval of 2007-08 led not only to an economic and fiscal crisis in many countries, but to social crises, too. Figure 1.8 presents selected outcome measures for which a "crisis link" is already clearly visible. Life satisfaction has declined much more steeply in countries where household incomes have fallen most (Figure 1.8, Panel A). The same is true for fertility rates (Panel D). Crisis-related effects on other outcomes, including

Figure 1.8. **Crisis exposure and policy shape key social outcomes**



Reading note: The average fall in fertility rates was 0.02 across countries with a "small" drop in household incomes, but 0.10 across countries with a "large" drop in household income.

Note: Country groups were constructed by comparing the change in the relevant indicator to the OECD average, as described in Annex 1.A1, resulting in the following groupings:

- **Household income.** Small decline (or growth): Austria, Canada, Chile, the Czech Republic, Denmark, Finland, Germany, Israel, Poland, the Slovak Republic, Sweden. Large decline: Estonia, Greece, Hungary, Iceland, Ireland, Mexico, New Zealand, Spain.
- **Public social spending.** High growth: Australia, Chile, Estonia, Israel, Korea, New Zealand, Poland, the Slovak Republic, the United States. Low growth: Germany, Greece, Hungary, Iceland, Italy, Portugal.
- **Recent consolidation effort.** Low: Denmark, Estonia, Finland, Germany, Korea, Norway, Sweden, Switzerland. High: Australia, France, Greece, Iceland, Ireland, Italy, Poland, Portugal, Slovenia, Spain, the United States.
- **Expected future consolidation effort.** Low: Australia, Austria, Denmark, Estonia, Germany, Korea, Luxembourg, New Zealand, the Slovak Republic, Slovenia, Switzerland. High: Greece, Japan, Portugal, the United Kingdom, the United States.

Source: See Annex 1.A and Chapter 7 "Life satisfaction", Chapter 5 "Poverty", Chapter 4 "Unemployment" and Chapter 3 "Fertility".

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health, take longer to materialise. The indicators presented in Chapters 3 to 7 provide a fuller picture of the social situation across the OECD and how it has changed since the crisis began.

The precise patterns differ from one indicator to another and the associations shown in Figure 1.8 are not prove of a causal relationships (for instance a third factor, such as unemployment, is plausibly causing the drops in both household incomes and life satisfaction). But whatever the mechanism behind them, the patterns underline that social outcomes have tended to deteriorate more in countries where households were particularly exposed to economic hardship during the downturn.

In addition to crisis exposure, the policy responses – discussed in Sections 2 and 3 below – matter as well. Fiscal pressures make it more difficult to provide adequate public support in countries where it is most urgently needed. The social and political burden of fiscal pressures is highlighted by the fact that the countries which made the greatest efforts to limit increases in social spending (the "low spending growth" countries in Figure 1.8) or reduce fiscal deficits (the "high recent effort" countries) did so against a background of declining incomes among the poor and increasing unemployment (Figure 1.8, Panels B and C). Importantly, the extent of economic hardship and the deterioration in broad life-satisfaction measures are also more sizable in countries with the greatest *future* fiscal consolidation needs ("high future effort" countries in Figure 1.8, Panels A, B, and C). Efforts to reduce public debt will therefore continue to come up against the tough task of implementing reform programmes that address immediate social concerns and priorities now, while remaining fiscally, socially and politically sustainable in the future.

2. Social policy responses to date

The nature of problems that households faced in the wake of the Great Recession did not come as a surprise. However, the scale of the resulting social policy challenges and the constraints of the ensuing fiscal crisis were only partially anticipated at the outset. As a result, governments' responses to the crisis have continued to evolve, as has their general policy stance. Initially, they increased social spending and put in place large fiscal stimulus packages that included greater resources for social measures. But the large fiscal imbalances that governments now face restrict the available policy options (Cournède et al., 2013). Although many European countries and the United States have recently narrowed budget shortfalls significantly, large government debts will see fiscal pressures persisting well into the rest of the decade and often beyond. Social spending, which remains part of most fiscal consolidation plans, looks set to come under further pressure – with potentially serious consequences for the capacity of social policy to provide crucial support.

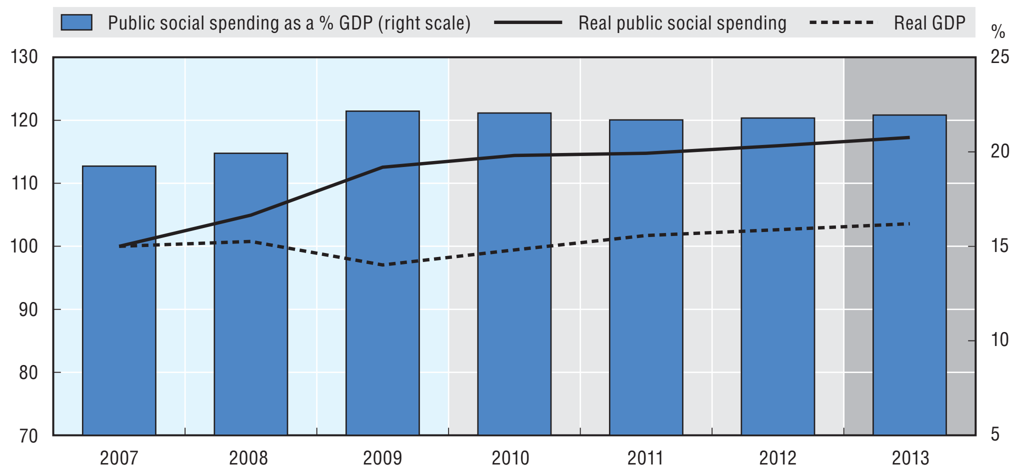
This section first discusses recent trends in social spending and in the number of people who rely on social support measures. It then assesses countries' fiscal consolidation efforts, the role social policies play in those efforts, and how the availability and quality of support are affected.

Social spending increased most in countries least affected by the crisis

The global economic crisis has led to a sustained increase in social spending both as a share of GDP and in real terms. On average across the OECD, the ratio of public social spending to GDP rose from around 19% in 2007 to 22% in 2009-10 and has remained at that elevated level (see Figure 1.9 and Chapter 5 "Social spending"). The sharp decline in GDP in some countries accounts in part for the rising spending/GDP ratios. However, with the exception of Greece and Hungary, social spending has also burgeoned in real terms (Figure 1.10).

Figure 1.9. **Social spending keeps rising in real terms, but has stabilised as a share of GDP**

Estimated trends in average public social spending in the OECD area



Note: Real-term figures are shown in index form, with a value of 100 in 2007.
Public social spending totals reflect detailed social expenditure programme data for 1980-2009, national aggregates for 2010-12, and estimates for 2013, and are based on national aggregates in national sources, the *OECD Economic Outlook* (No. 93, May 2013), and the *European Commission's Annual Macroeconomic Database* (AMECO, May 2013). Details of estimates for recent years are provided in Adema, W., P. Fron and M. Ladaique (2011), "Is the European Welfare State Really More Expensive? Indicators on Social Spending, 1980-2012 and a Manual to the *OECD Social Expenditure Database* (SOCX)", *OECD Social, Employment and Migration Working Papers*, No. 124, *www.oecd.org/social/expenditure.htm* and *http://dx.doi.org/10.1787/5kg2d2d4pbf0-en*.
Data for Turkey are not available, and information on national spending aggregates is not available for Japan beyond 2010 or for Chile, Korea and Mexico beyond 2012.
Spending totals for 2010 to 2012 (light shade) are subject to revision, but these are likely to be slight. The estimates for 2013 (dark shade) are most likely to be affected by later revisions to expenditure and GDP data.
Source: OECD (2013), *OECD Social Expenditure Database (SOCX)*, preliminary data, *www.oecd.org/social/expenditure.htm*.

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Strikingly, the biggest increases in expenditure between 2007/08 and 2012-13 came in countries with relatively strong GDP growth and greater spending power, and not in those where deep downturns produced the greatest need for support (Figure 1.10). Some countries with significant GDP drops did, however, respond to deep or long-lasting downturns with substantial hikes in social spending (e.g. Estonia, Finland, Ireland, and Spain). There were others, though, like Italy and Portugal, where increases were only slight over the whole period. Real public social spending was substantially *lower* than before the crisis in Greece and Hungary, where it was down 17% and 11% respectively. The cuts made by the two countries illustrate the difficulties of maintaining a counter-cyclical policy stance in a severe downturn.

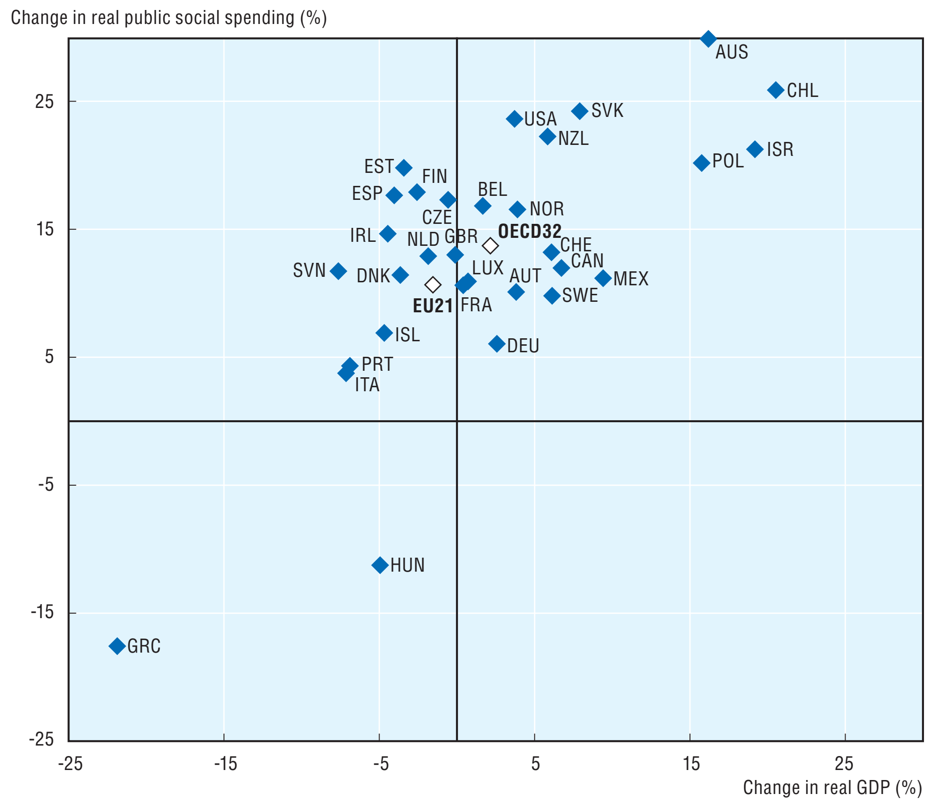
Transfers to working-age individuals driving upward trends in social expenditure

Benefits typically paid to working-age people and their families make up only one-fifth of total public social spending. Yet they account for close to one-third of increases in expenditure since the onset of the crisis. Over the previous two decades, almost all OECD countries reduced transfers to working-age individuals and children – from 27% in 1985 to 21% in 2005 (Immervoll and Richardson, 2011). The Great Recession brought this downward trend to an abrupt end, as unemployment benefits, general social assistance, disability benefits, and cash family benefits increased (see Figure 1.11). On average across the OECD, spending on these "working-age transfers" has risen by some 17% in real terms.

Much of the increase in social spending early in the downturn was prompted by the rise in out-of-work benefits, especially unemployment insurance, which act as a first line

Figure 1.10. **Social spending increased least in countries most affected by the crisis**

Percentage changes in real public social spending and real GDP, 2007/08 to 2012/13



Note: See notes to Figure 1.9. Estimates for 2007-08 and 2012-13 are averaged over two-year periods to allow for the different years in which the crisis began across countries and to limit the effect of year-on-year fluctuations.

Source: OECD (2013), *OECD Social Expenditure Database (SOCX)*, preliminary data, *www.oecd.org/social/expenditure.htm.*

StatLink http://dx.doi.org/10.1787/888932966048

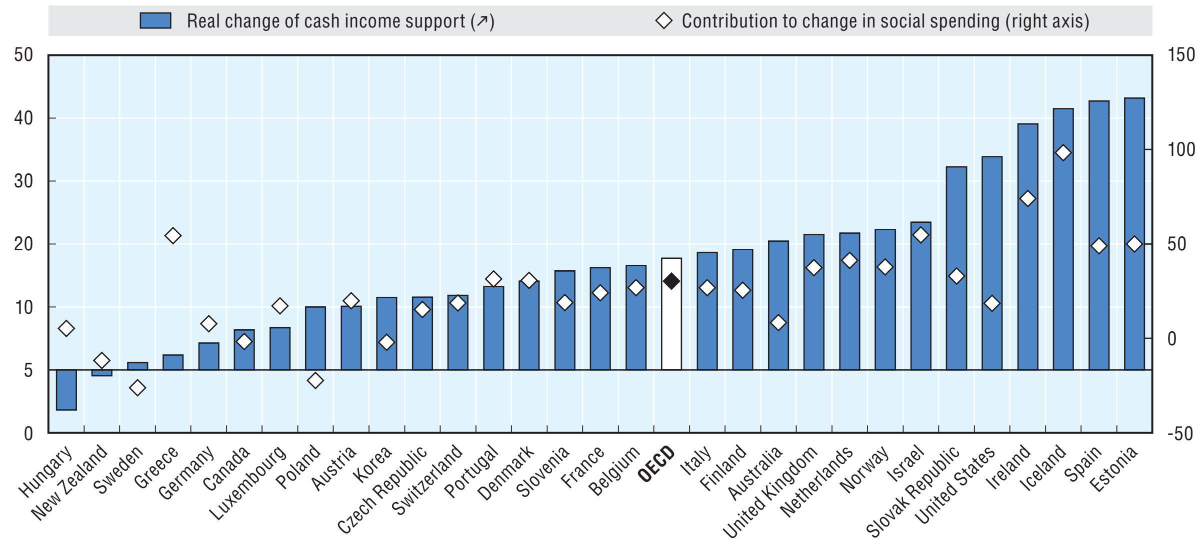
of defence against income drops for job losers. Several countries also boosted spending on "partial" unemployment benefits or "short-term working schemes" (Hijzen and Venn, 2011). Such programmes, which provide income support for those affected by temporary cuts in working hours and earnings, can reduce or slow initial job losses and spread the economic burden of a temporary downturn more evenly across income groups (Bargain et al., 2011; Hijzen and Martin, 2012).

As the crisis progressed, however, expenditure on lower-tier assistance benefits (safety-nets for those who are not, or no longer, entitled to insurance benefits) started rising, too, especially in countries with persistently high unemployment and short-duration unemployment insurance benefits. On average across the OECD, unemployment compensation increased by about 80% in real terms (from an average of 0.7% of GDP in 2007 to 1.1% in 2009). With increases of more than 200%, spending rose most steeply in Estonia, Iceland, and the United States and doubled in Turkey, Ireland, Japan, the United Kingdom, and New Zealand.

Spending increases were driven more by rising numbers of beneficiaries than by higher entitlements per recipient. Although support for the unemployed tended to become less generous in the years prior to the crisis (Immervoll and Richardson, 2013), there was very little change OECD-wide in the overall generosity of jobless benefits between 2007 and 2011. Figure 1.12 shows the net replacement rate (NRR) – the ratio of income received when not in work to that received in work – for a single individual over a long spell of

Figure 1.11. **Spending on working-age cash transfers rose steeply**

Changes in spending on working-age benefits and their share in changes of total public social spending
In percentages, 2007/08-2012/13



Notes: See notes to Figure 1.9.
"Working-age" cash transfers include the following spending categories: incapacity benefits (disability and sickness), family cash benefits, unemployment and so-called "other social policy areas" (which includes minimum-income benefits).
The contribution of changes in "working-age" transfers to changes in total social spending is calculated in relation to spending as a percentage of GDP. Chile, Japan, Mexico and Turkey are not included as breakdowns by spending category are not available.
Estimates for 2007-08 and 20012-13 are averaged over two-year periods to allow for the different years in which the crisis began across countries and to reduce the effect of annual fluctuations.
Source: OECD (2013), *OECD Social Expenditure Database* (SOCX), preliminary data, *www.oecd.org/social/expenditure.htm.*
StatLink http://dx.doi.org/10.1787/888932966067

unemployment. NRR changed by less than 5% over a five-year period in around half of all OECD countries and by less than 10% in some others.

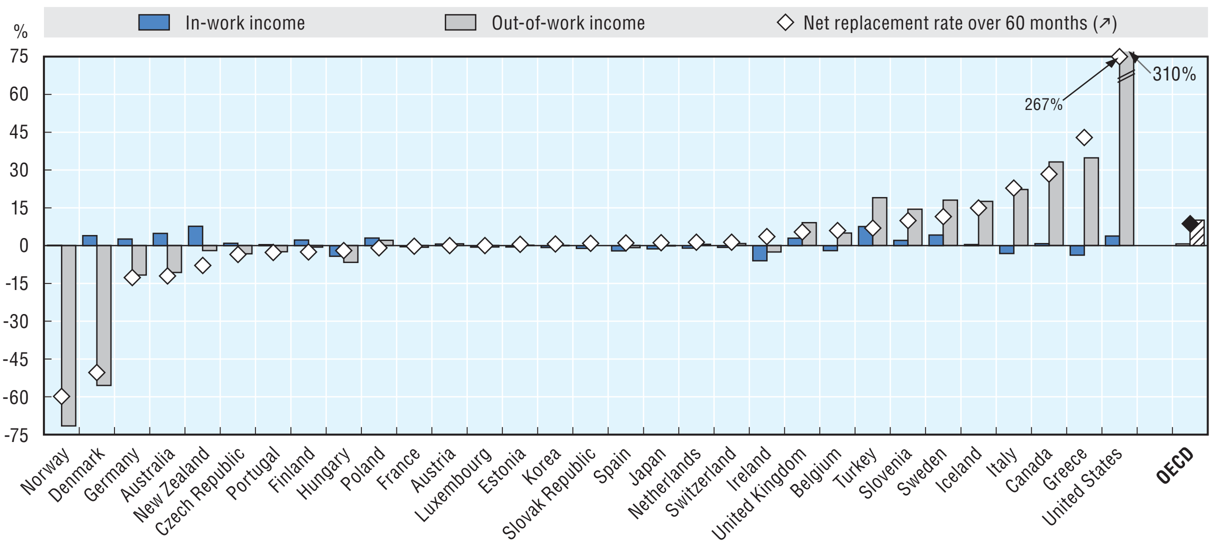
Individual countries did, however, introduce sizeable reforms. Among countries showing declining NRR, the drops were largely due to an erosion of benefit levels relative to wage growth, and not to explicit cuts in nominal benefit levels (countries such as Germany, Australia, and New Zealand).[11] However, both Norway (prior to the crisis) and Denmark (from 2010) shortened benefit durations, thereby reducing NRRs for people with long unemployment spells.[12] Longer benefit durations increased NRRs for the long-term unemployed in a few countries – the United States, Greece, Canada, and Italy. In the United States, the very large increases were driven by temporary benefit extensions from the standard 26 weeks to 99 weeks. Although the changes in the United States stemmed largely from new legislation, they also reflected automatic extensions that are triggered once state unemployment exceeds or drops below a certain threshold. Canada also operates a system of automatic benefit duration adjustments that depend on provincial unemployment rates.[13]

People not eligible for unemployment benefits may be entitled to receive minimum-income benefits as a follow-up. However, the value of minimum-income benefits generally remained significantly below commonly used relative poverty thresholds across the OECD. Those exhausting unemployment benefits before they find work therefore risk suffering extended periods of income poverty (Chapter 5 "Living on benefits").

In countries where family support is largely income-tested, public spending on family cash benefits increased as incomes started to fall. In the early years of the crisis (2007-09), average spending on family benefits across OECD countries rose by 0.3 percentage points

Figure 1.12. **Unemployment benefit amounts changed little, but durations were extended substantially in some countries**

Percentage change in long-term net replacement rates, 2007-11



Note: The net replacement rate is calculated for a single individual with a "low-paid" job prior to becoming unemployed (67% of the average wage). It is a synthetic indicator that averages out-of-work incomes over a hypothetical five-year unemployment spell. By showing the replacement rate averaged over a long unemployment spell, the indicator captures changes in both benefit levels and duration. Calculated incomes in work and out of work take into account income taxes, own social contributions, in-work benefits, unemployment insurance and assistance. Means-tested minimum-income and housing benefits are not included. For the generosity of these benefits, see Chapter 5 "Living on benefits".

In Ireland, both in-work income and out-of-work benefits fell. The fall in in-work income was stronger, so increasing the NRR.

The only countries which showed relatively large NRR changes since 2010 were Germany (reduced generosity due to the termination of a transition payment for those moving from insurance to assistance benefits) and Greece (higher NRR due to a combination of increased nominal benefit value and wage deflation).

Source: OECD Tax-Benefit Models, *www.oecd.org/els/social/workincentives*.

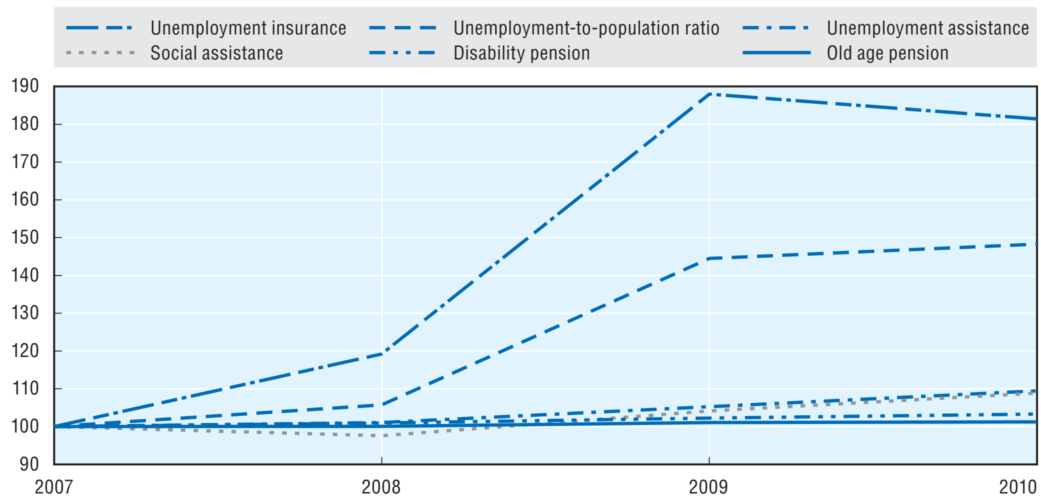
StatLink *http://dx.doi.org/10.1787/888932966086*

of GDP – an increase of 10% in real terms. The biggest rises were seen in Korea (50%), Greece (30%), Ireland and Portugal (20%), and in the United Kingdom (10%). Family support is also likely to have gone up in countries where it is delivered as tax credits (although such data are not available for all countries on a comparable basis). In the United Kingdom, for example, Child and Working Tax Credits helped to cushion the effect of the crisis on poor families. Higher numbers of low-income families led not only to more claimants, but also to more receiving the maximum benefit, although policy changes in 2012 reduced the number of recipients (OECD, 2014b; HM Revenue and Customs, 2013).

In sharp contrast with previous recessions, receipt of neither old-age pensions nor disability benefits receipt has increased significantly (Figure 1.13 and Chapter 5 "Recipients of out-of-work benefits"). In previous downturns, early retirement and disability programmes were frequently used to ease pressures in the labour market. Since those who join such schemes do not typically re-enter the labour market during a recovery, the practice led to large, practically irreversible increases in social expenditures. In the current crisis, there has not been a massive inflow of unemployed people into early retirement or disability benefit programmes. Instead, recent changes in receipt of these transfers have continued to be driven primarily by demographic factors. In the case of disability programmes, structural reforms – designed to strengthen gate-keeping, the assessment of health conditions, and incentives to return to work – appear to have made them more resilient to changes in the economic cycle (some relevant reforms are highlighted below).

Figure 1.13. **More people receive unemployment benefit, but receipt of "inactive" benefits has largely remained stable**

OECD total, number of recipients in 2007 shown as 100



Note: Unemployment and benefit recipient ratios relative to the working-age population (total population for old-age benefits).
Source: Calculations based on OECD (2014), *Social Benefit Recipients Database*.

StatLink http://dx.doi.org/10.1787/888932966105

Pension spending tends to be much less sensitive to the business cycle once countries close access to early retirement, which many have done.

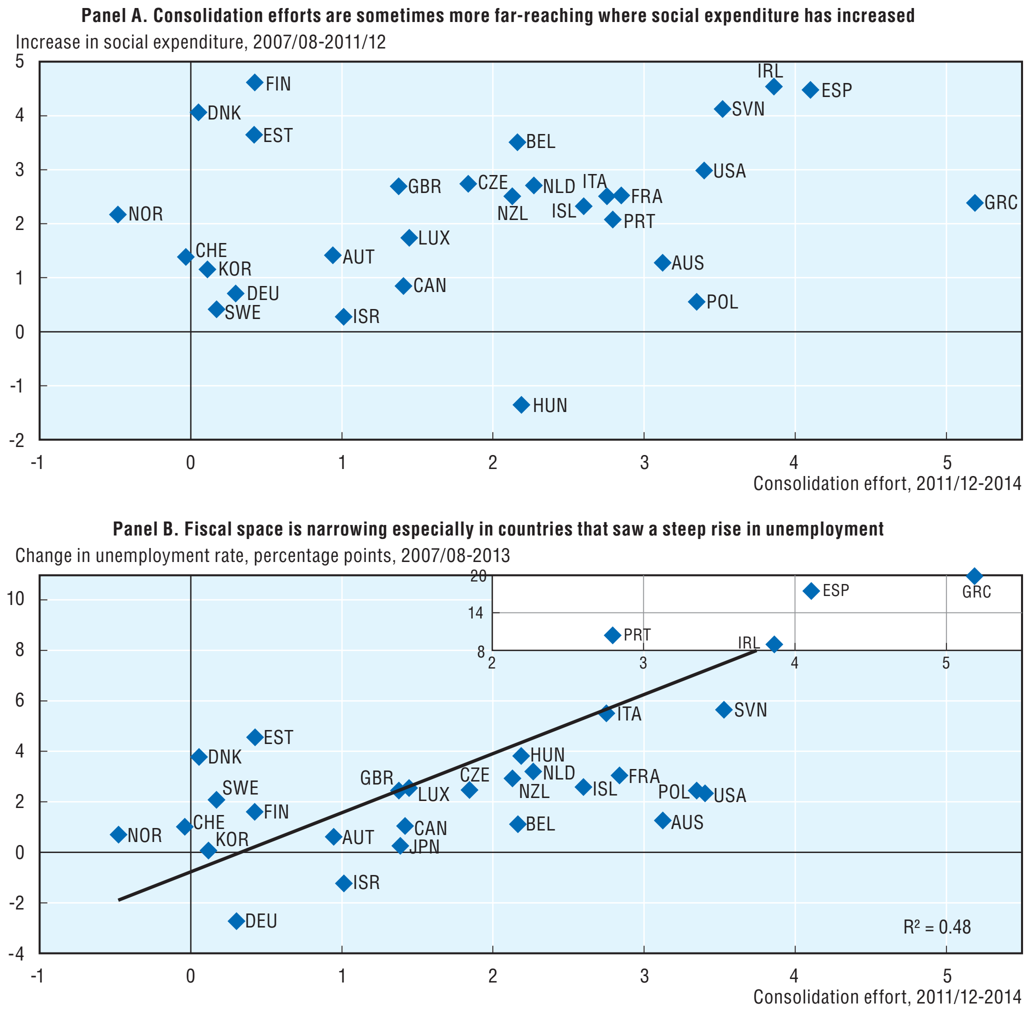
But social policies are now at the core of fiscal consolidation

Reduced fiscal space risks compromising continued provision of social support

Fiscal space has been shrinking in most OECD countries, putting more pressure on social spending as governments reduce budget deficits. In 2009 and 2010, the net lending positions of OECD governments slid from their 2007 heights. OECD projections for 2013 and 2014 do not foresee them returning to balance in the near future – with the exception of countries which ran surpluses prior to the crisis, such as the Nordic countries, Australia, and Germany. Structural deficits which existed before 2008 have widened since and will not disappear without consolidation efforts and a return to growth. Planned consolidation is often more far-reaching precisely in countries that where social expenditures have increased as a share of GDP (Figure 1.14, Panel A).

Scrutiny of projected consolidation efforts suggests that pressures to address budget shortfalls are greatest in countries that have experienced the steepest rises in unemployment (Figure 1.14, Panel B). Such is the outlook for a number of Eurozone countries, although a similar picture also emerges for other OECD countries, albeit to a lesser extent. When unemployment rises fast, governments' fiscal problems are heightened both by increasing expenditures and by contracting revenues. The pattern documented in Panel B of Figure 1.14 is therefore not surprising. But it underlines concerns about the ability of governments to effectively address rising social needs and about the timing and substance of consolidation efforts on the tax and the spending sides. In many countries, consolidation pressures will persist well beyond the next two years, with significant pressures for further consolidation over the next 10 to 15 years (OECD, 2013k; IMF, 2012b).

Figure 1.14. **Rising social spending and social needs, but decreasing fiscal space**



Note: See notes to Figure 1.9. Averages for 2007/08 and 2011/12 are used as the timing of the downturn and the beginning of any fiscal consolidation efforts varied across countries.
"Consolidation effort": change in underlying primary balance, percentage points of GDP.
"Increase in social expenditure": change in social expenditure, percentage points of GDP.
Source: OECD (2013), *OECD Economic Outlook: Statistics and Projections*, No. 93, May, *www.oecd.org/economy/outlook/economicoutlook.htm* and *http://dx.doi.org/10.1787/data-00655-en*; OECD (2013), *OECD Social Expenditure Database* (SOCX), *www.oecd.org/social/expenditure.htm*.

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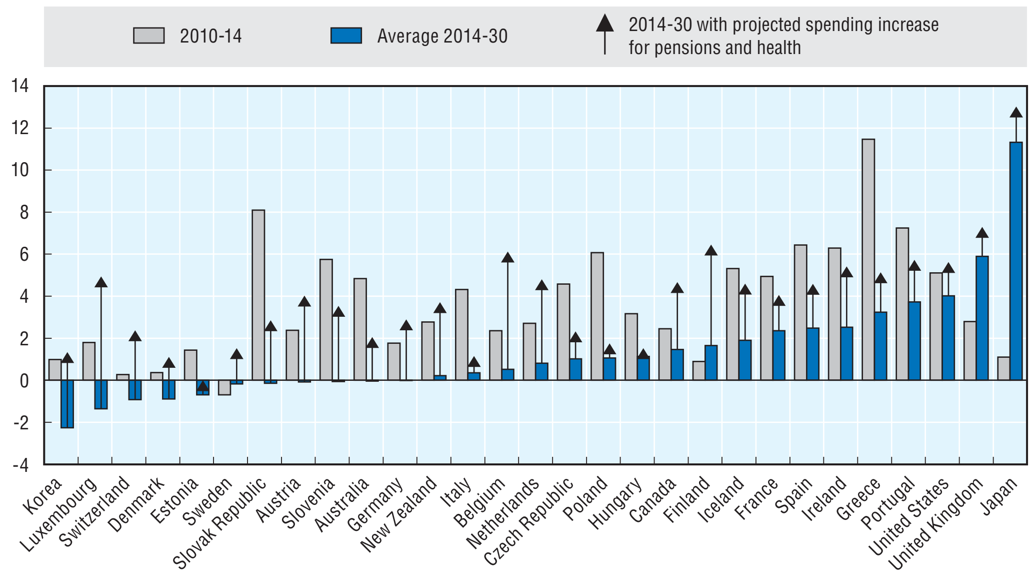
Figure 1.15 shows one possible measure of expected future consolidation pressures. The United States and a number of countries in Europe have already implemented or announced policies that are expected to reduce budget shortfalls very significantly relative to their 2010 levels (light grey bars). Most, however, will need to reduce deficits further and maintain this tighter fiscal stance through to 2030 if they are to put government debt on the downward path to a 60% of GDP target (dark blue bars).

Importantly, however, these projections do not account for the expected increases in government spending on health and pensions due to ageing and other factors. If estimates of these additional outlays are factored into projected expenditure, the prospect of achieving the putative 60% target becomes significantly more remote: as the arrows in Figure 1.15 illustrate, significant fiscal pressures will remain in the medium term, even in countries that would otherwise have a more positive fiscal outlook. The inference is that

Figure 1.15. **Fiscal pressures will persist well into the next decade**

Short-term consolidation efforts (2010-14) and medium-term consolidation scenarios (2014-30)

Change in the primary budget balance, in percentage of GDP



Note: Over the 2014-30 projection period countries with *gross* government debt ratios in excess of 60% of GDP are assumed to gradually reduce debt to this level, whereas other countries stabilise debt ratios at their current levels. Consolidation requirements from 2014 to achieve these objectives are measured as the difference between the underlying primary balance in 2014 and its average over the period to 2030 (or until the debt ratio stabilises). Due to very high initial debt levels, and despite a very large average fiscal consolidation requirement of 11 percentage points relative to the 2014 balance, the scenario for Japan only broadly stabilises gross debt between 2014 and 2030 at a level of over 200% of GDP.

Source: OECD (2013), *OECD Economic Outlook*, No. 93, *http://dx.doi.org/10.1787/data-00655-en*.

StatLink http://dx.doi.org/10.1787/888932966143

pro-cyclical consolidation efforts during recessions or low-growth periods are no substitute for longer-term, structural measures that put government finances on a sustainable footing.

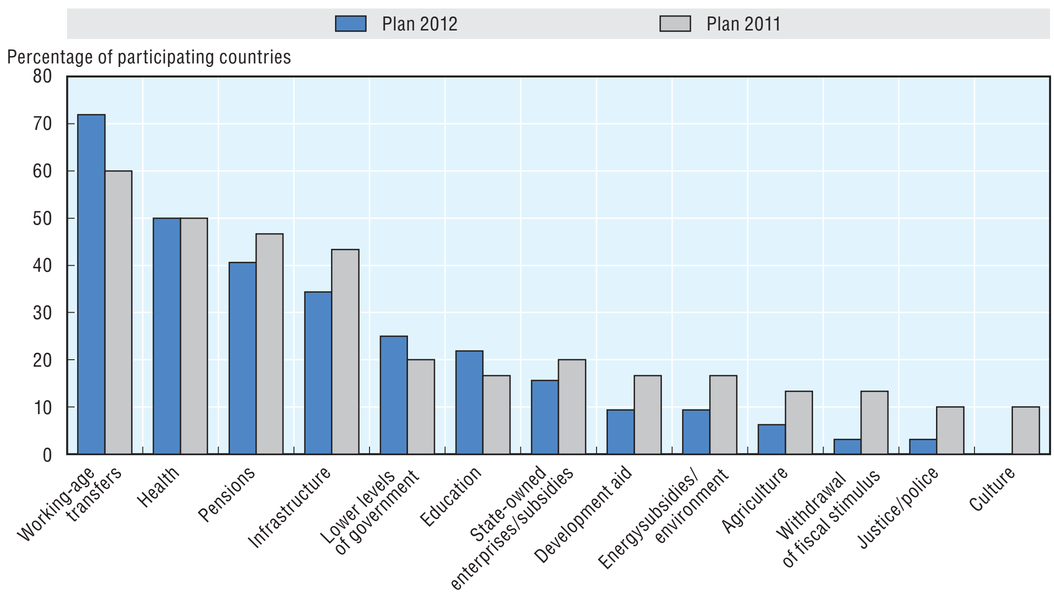
Social transfers have been the main target of consolidation measures

Of all areas of public spending areas, social transfers have been the focus of by far the greatest number of consolidation measures since 2011. Country responses to OECD policy questionnaires reveal that the category most frequently selected for savings was "working-age transfers" (unemployment, social assistance, disability and family benefits), followed by health care and old-age pensions (Figure 1.16). In addition, many consolidation plans include unspecified savings – in other words, no details are given on savings that take the form of general spending cuts across departments. Although such unspecified measures may involve sizeable cutbacks (e.g. EUR 3 billion between 2011 and 2014 in Ireland) and affect social policy areas, they are not included in the breakdown in Figure 1.16.

More than two-thirds of OECD countries reported plans to reduce spending on "working-age transfers" in 2012. Greece planned to reduce them by 1.9% of GDP (through cuts in social security funds and social spending). This is the largest reduction in the OECD area. Under the same heading, Ireland, Hungary, Poland, Germany and the United Kingdom planned spending cuts totalling more than 1% of GDP. The United Kingdom revised and increased its planned expenditure reductions from 0.4% of GDP in 2011 to 1.1% in 2012 through cuts in child and disability benefits. France, Iceland, and the Netherlands planned to make savings on working-age transfers that accounted for more than 0.6% of GDP.

Figure 1.16. **Social transfers are more often part of consolidation plans than other areas of public spending**

Major programme measures in fiscal consolidation plans, by area of public spending



Reading note: 70% of countries have planned to cut welfare spending in 2012.

Note: "Working-age transfers" include unemployment benefits, social assistance, housing benefits, disability benefits and family benefits. "Pensions" denotes old-age pensions only.

Source: OECD (2012), *Restoring Public Finances*, *2012 Update*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/9789264179455-en*.

StatLink http://dx.doi.org/10.1787/888932966162

Health care was the second most frequently targeted area for fiscal savings, with some 50% of countries reporting planned reductions. Health was a major focus of consolidation efforts in the countries with IMF/EU Economic Adjustment Programmes: Greece, Ireland and Portugal. Ireland and Portugal expect to reduce health expenditure by as much as 1% of GDP. Belgium, too, raised its savings target in health care to 1% of GDP and Spain to 0.7%.

Countries use different approaches to achieve savings

Working-age benefits so far the main focus of expenditure reductions. Recent savings measures to reduce expenditures on income support for working-age people and their families have focused mainly on unemployment insurance programmes and on family and child benefits. Until now, there have been no major changes to lower-tier assistance programmes that secure minimum living standards. Some countries have however introduced several smaller changes that, in combination, made safety-net benefits considerably less accessible or generous.

- Some temporary measures to extend the duration or coverage of *unemployment insurance* programmes are being phased out (Table 1.1). Some countries, e.g. Greece, have not renewed temporary unemployment benefit measures taken in 2009-10, while others are now reversing planned extensions of benefit durations (e.g. Spain). In the United States, several states have begun cutting benefit durations, sometimes significantly, even as federal extensions have remained in place until the end of 2013. However, because federal extensions are conditional on state benefit rules, they were also affected by the cuts. Some other countries have reduced the maximum duration of insurance programmes (Denmark, Hungary, Portugal) or tightened eligibility conditions (Czech Republic, Spain) in order to strengthen job-seeking incentives or contribute to fiscal consolidation. However, Portugal has recently eased eligibility requirements, making benefits available to those with shorter employment histories, and has introduced a bonus payment for families where both parents receive benefits.

Table 1.1. **Significant changes to unemployment, minimum-income, and incapacity benefits**

		Eligibility	Benefit level or duration	Programme starts (+) or ends (-)	Details
			Guaranteed minimum income		
Austria	2011		+		Benefit rules unified across states, resulting in higher benefits in some.
Czech Republic	2012		+		Minimum living and subsistence benefit harmonised.
Estonia	2011		+		Nominal base for calculating guaranteed minimum income adjusted.
Finland	2012		+	+	Higher benefit value and new supplement for lone parents.
Greece	2009			+/-	Lump-sum benefits for civil servants and support towards heating costs: introduction and subsequent termination.
Hungary	2010-12	-	-		Eligibility tightened and benefit levels lowered.
New Zealand	2013	-			Lone parents expected to look for work once child aged 14.
Poland	2012	+	+		Adjusted benefit level, also to offset erosion since last adjustment in 2006.
Portugal	2010-13	-	-		Lower supplements for children and spouse, lower income and asset ceilings, means testing now includes resources of those outside nuclear family.
United Kingdom	2012	-			Lone parents expected to look for work once child aged 5.
	2013		-		Cap on total amount of state benefits that can be received by working-age claimants. Lower housing benefits for larger housing units.
United States	2009-13		+/-		Increased real value of maximum SNAP allotments, mostly reversed in 2013.
			Unemployment benefits		
Austria	2013	+	-		Supplement for recipients who attend public employment services training schemes.
Australia	2012				Wage subsidy to encourage employers to take on eligible people who have been unemployed for at least two years.
Canada	2009		+	+	Duration of unemployment insurance extended, more generous earnings exemption, new programme for self-employed and for parents of ill children.
Czech Republic	2011-12	-	-		Contribution requirements tightened and benefit levels reduced.
Denmark	2010		-		Duration of unemployment insurance reduced.
Finland	2009-12	+		-	Basic allowance increased in 2009 and again in 2012.
	2013		+		Spouse's income no longer included in means test for assistance benefits.
France	2009-10	+	+	-/+	Contribution requirements for unemployment benefit reduced . Duration of unemployment benefit slightly lengthened. One-off payment for jobseekers not entitled to unemployment benefit (introduced 2009) phased out.
Germany	2009-12		-		In 2011 transitional UBII discontinued. (UBII was a payment that offset loss of benefit loss for people transitioning from unemployment benefit to unemployment assistance). The real value of UBII levels themselves had changed little since 2009
Greece	2010			-/+	Lump-sum benefit introduced then phased out.
	2012	+	-		UI benefit cut by 22%. UA income limits made less stringent.
	2013		-		Maximum total benefit duration during any four-year period reduced.
Hungary	2011	-	-		Eligibility tightened, duration of unemployment benefits shortened.
	2012			-	Unemployment assistance abolished.
Japan	2011-12	+	+		Duration of unemployment insurance extended.

Table 1.1. **Significant changes to unemployment, minimum-income, and incapacity benefits** *(cont.)*

		Eligibility	Benefit level or duration	Programme starts (+) or ends (-)	Details
Netherlands	2010			+	Temporary unemployment assistance for older workers introduced.
Poland	2010		+		Increased benefit over first 3 months.
Portugal	2009		+		Unemployment assistance: temporary increase in amount and length of benefit.
	2010		-		Unemployment assistance: temporary increases discontinued and means testing tightened.
	2012	+	-	+	Unemployment insurance: eligibility eased; duration shortened, ceiling lowered; reduced 10% after 6 months; 10% supplement when both parents receive unemployment benefit; new unemployment benefit for self-employed in quasi-employment.
Spain	2009			+	Temporary lump-sum payment introduced for participants in labour-market preparation schemes.
	2011/12		-		Lower unemployment insurance benefit after 6 months/lower lump-sum payment for participants in labour-market preparation schemes.
	2013	-			Unemployment insurance: job-search requirements tightened; reduced scope for keeping benefits after moving abroad. Unemployment subsidy for older people: age threshold raised from 52 to 55; more restrictive income test.
Slovenia	2011		+		Higher benefit during first 3 months of unemployment.
United States	2008-11		+		Discretionary and automatic extensions of UI benefit duration (state and federal).
	2012			-	Beginning reversal of state-level extensions (also reduces federal extensions).
			Disability and sickness benefits		
Austria	2013	-			Access to pensions tightened for white-collar employees and skilled workers.
Australia	2012	-			Disability pensions eligibility tightened.
	2011/12	+			List of recognised disabilities amended/carer benefits eligibility extended.
Czech Republic	2012				Ten benefits for the disabled merged into 2 new benefits.
Finland	2012		-		Changes in reimbursements for pharmaceutical expenses.
Greece	2012	-			Eligibility rules improved and simplified to enhance fraud control
Netherlands	2013	+			Incentives for temporary workers and employers in the event of long-term illness.
New Zealand	2013	-			Sickness benefit combined with unemployment benefit as incentive to seek work.
Poland	2013	-	+		Stricter eligibility rules, higher benefits for parents of disabled children.
Spain	2013		-		Benefit calculation index revised for less generous amounts (law 27/2011).
	2013			+	*Convenio especial* (special scheme) ensures continued contributions to old-age pensions for certain groups of incapacitated unemployed.
Japan	2015	+			Increased benefits for low-income pensioners.

Note: Reforms were selected if their design or timing was plausibly linked to the economic downturn or fiscal consolidation.
A “-” means less generous: cancellation of a programme, stricter eligibility conditions, or lower benefit levels or indexation rules. A “+” means the reform heads in the opposite direction.
For Canada, information does not include Quebec.
SNAP: Supplemental Nutrition Assistance Program (formerly “Food Stamps”).
Years refer to the time when measures first took effect but do not indicate the planned duration or any phase-in provisions. The table does not show measures that are planned but not yet implemented.
Source: OECD Tax-benefit Policy Database and OECD 2013 questionnaire on social policies in the crisis.

- In parallel, *unemployment assistance* programmes for those not, or no longer, entitled to insurance benefits have been bolstered in some countries. Portugal increased benefit durations and payments, before reversing the measures in 2010. Greece more than doubled the income limits that determine eligibility to unemployment assistance. But eligibility remained restricted to those aged 45 or older, coverage among the long-term unemployed remains very low as a result, and the real value of benefits has declined as nominal amounts have remained unchanged for the past ten years (Matsaganis, 2013). From 2014, the government plans to extend eligibility to all low-income long-term unemployed, irrespective of age. Finland raised its basic allowance, while Austria has improved benefits for the unemployed who attend training programmes. In the Netherlands, a temporary assistance benefit for older unemployed people was introduced in 2010 (and is to expire in 2016). France extended a similar type of programme earlier on during the crisis. There are only a few instances of assistance benefits being cut: Hungary abolished unemployment assistance, tightened access to social assistance, and reduced the duration of unemployment insurance; Portugal introduced stricter means testing; and Germany abolished a transitional payment for those moving from insurance to assistance benefits (though the measure was not crisis-related).
- Some countries have pursued structural reforms of *disability benefits* by introducing stronger gate-keeping mechanisms, time-limiting benefits, or reassessing the eligibility of existing recipients. Reforms aim to avert the risk of the long-term unemployed drifting into disability benefit schemes and contribute to curbing long-term expenditure. Such policies have been introduced in Sweden, the Netherlands, Switzerland, and the United Kingdom – all countries that have generally been able to put disability benefit claims on a declining trend. By contrast, other countries that have experienced steep rises in unemployment but failed to reform disability benefit now face mounting beneficiary rates – in Estonia and the United States they have risen by over 10% (OECD, 2014b). However, without appropriate employment support, comprehensive reassessments of health entitlements and tighter eligibility criteria can also increase poverty as vulnerable people are excluded from income transfers altogether.
- Some countries bolstered lower-tier social *safety-net programmes*, such as minimum income schemes, prior to the crisis. In comparison with unemployment benefits, minimum-income benefit reforms were fewer and less far-reaching. Measures to strengthen benefit provisions included reforms in the Czech Republic, Estonia, Finland, France, Poland and the United States [although increased allotments under the Supplemental Nutrition Assistance Program (SNAP) are to be widely reversed in late 2013]. Korea is to provide a wider range of separate social assistance transfers from 2014, which is expected to increase the number of people receiving support while reducing some benefits. Italy has announced plans for a new minimum-income programme, while Greece is to introduce a minimum-income benefit on a pilot basis and intends to introduce means-tested housing assistance. However, some countries have reduced the generosity of benefits or made them subject to more stringent job-search requirements with the stated objective of raising the incentive to work. Two examples are New Zealand and the United Kingdom. In other countries, the main motivation was, arguably, to reduce spending. In Hungary and Portugal, measures to reduce benefits and make them less easily accessible were followed by substantial drops in recipient numbers despite high rates of long-term unemployment. In Portugal, for instance, the number of families receiving the Social Integration Income fell by some 30% between early 2010 and July 2013 (SPC, 2013; Farinha Rodrigues, 2013).

- Savings measures have included *child or family-related benefits* since 2010. Before 2010, several countries increased such benefits (which included tax allowances) on a temporary basis (Table 1.2) after having extended them in pre-crisis years. In Germany, Italy and Hungary, one-off benefits were paid to families in need, while France has reduced income taxes for low-income families (France also recently passed a law that will raise them for better-off families with children from 2014). Since 2010, consolidation measures have frequently included lower benefits for children or for childcare. However, such moves constitute a mixed bag and include both cuts and new entitlements, as in the United Kingdom, for example. A number of countries have simply frozen benefits and/or tightened eligibility conditions (e.g. Australia, Greece, Hungary, the Netherlands and the United Kingdom), while others, like the Czech Republic and Estonia, have capped or cut birth-related benefits or reduced the generosity of their parental leave policies. While less visible than explicit benefit reductions, “freezing” benefit payments by delaying, suspending, or reducing regular adjustments in line with consumer prices or earnings can yield significant savings over time. However, such moves typically erode the incomes of families, particularly of those with children (Whiteford, 2013; Joyce and Levell, 2011; OECD, 2007; Immervoll and Richardson, 2011).

Table 1.2. **Significant changes to family-related benefits (family/child/child-birth/childcare benefit)**

	Type of benefit		Eligibility	Benefit level or duration	Programme starts (+) or ends (-)	Details
Australia	Various	2009-13	-	-	+	Less generous or no indexation of benefit amounts and/or income limits, new paid parental leave, new benefit for school-age children.
Austria	Family benefit	2009		+		One-off family allowance.
	Tax credit	2009		+		Higher tax credit for childcare.
Canada	Tax Credits	2011		+		Higher non-refundable credits for children.
	Maternity Leave	2012	-			Maternity and parental benefits subject to authorisation to remain in Canada.
Czech Republic	Income tax	2009	+			Temporary reduction for low-income families.
	Family benefit	2011/12		-	-	Social allowance abolished/parental allownc. reduced.
	Maternity leave	2009		-		Lower replacement rate.
	Birth grant	2011	-	-		More restrictive and less generous.
Estonia	Tax break	2009		+		Increase for families with 2 or more children.
	Tax credit	2009		-		Additional tax-relief removed.
	Family benefit	2011	-			Can no longer be combined with paid parental leave.
	Study loans	2009		-		For parents with children in school.
Finland	Child benefit	2013		-		Suppression of inflation adjustments (2013-15).
France	Family benefit	2009		+		One-off family allowance top-up.
	Income tax	2009	+			Reduced bottom-tier tax.
	Childcare	2009/12	+	+		One-off increase in childcare vouchers/easier access to childcare benefit for lone parents.
Germany	Homecare allowance	2013			+	For children aged 15-36 months who are not in subsidised childcare.
Greece	Maternity leave	2009	+			Mothers working in the private sector included.
	Child benefit	2012		+	+	New means-tested benefit.
	Family benefit	2012	-	-	-	Benefits for large families (3 or more children) abolished.
Hungary	Family benefit	2009		+		One-off payment for low-income families.
	Childcare provision	2009		+		Extension for low-income families.
	Family benefit	2011		-		Temporary freeze on universal allowance.
Ireland	Maternity leave	2009		+		Higher replacement rate.
	Childcare	2009		+		Free pre-school year.
	Child benefit	2009	-	-		Restricted age range and lower benefit.

Table 1.2. **Significant changes to family-related benefits (family/child/child-birth/childcare benefit)** *(cont.)*

	Type of benefit		Eligibility	Benefit level or duration	Programme starts (+) or ends (-)	Details
Israel	Family benefit	2013		-		Lower benefit and new income ceiling.
Italy	Family benefit	2009		+	+/-	Lump-sum to low-income families; temporary increase in family allowance.
	Birth grant	2009		+		Temporary lump sum payment.
	Childcare	2013			+	Childcare voucher for mothers not using parental leave.
Japan	Child benefit and birth grant	2010/11/12		+		Amount increased.
Korea	Childcare	2013	+			Childcare subsidy no longer income-tested.
Luxembourg	Childcare provision	2009		+		New voucher for children under 12.
Netherlands	Childcare	2013	-	-		Support and income ceiling lowered. New asset test.
Poland	Family benefit	2012	+	+		Higher benefit level and income limit, also to offset erosion since last adjustment in 2004.
Portugal	Child benefit	2009		+		Low-income education allowance extended to all income groups.
		2010		-		Reversals of education allowance extension and of 2008 25% benefit bonus.
		2011	-			Income ceiling lowered; More frequent assessments to reduce overpayments.
Spain	Birth grant	2008-10			+/-	Birth grant introduced in 2008, abolished in 2010.
Sweden	Family benefit	2010		+		Amount increased.
United Kingdom	Child benefit	2009		+		Amount increased.
		2013		-		Income ceiling for benefit receipt introduced.
	Tax credits	2009	-			Income ceiling lowered.
		2011		+/-		Higher child element, baby element abolished, steeper benefit withdrawal.
		2012	-			Work requirement for couples with children increased.
		2011-13		-		Disregards for income changes made stricter.
	Birth grant	2011			-	“Health during pregnancy” grant abolished.
	Childcare	2011		-		Childcare elements of tax credits cut to 70% of cost.
		2013	+			15 hour-per-week free childcare extended to 2-year old children from disadvantaged families or in care.
United States	Tax credit	2009-11		-		

See notes to Table 1.1.

Source: *OECD Family Database* and OECD 2013 questionnaire on social policies in the crisis.

Resources for active labour market policies and services have not kept up with rising demand. With an OECD average of around 1% of general government spending, active labour-market polices account for a much smaller share of public expenditures than cash benefits. But while spending on income support for the unemployed is strongly counter-cyclical, expenditure on active labour market policies (ALMP) tends to expand only modestly during downturns, with the notable exception of the Nordic countries. During the recent economic downturn, total spending did increase more than in previous ones. Nevertheless, averaged across OECD countries, ALMP spending *per unemployed person* declined by some 20% (OECD, 2012). When dwindling resources have to contend with greater demands on employment services and other ALMPs it becomes more difficult to serve job seekers effectively. Lower resources per unemployed person are a concern during high-unemployment periods when jobseekers struggle to find work on their own and the demand for job-seeking assistance and labour market programmes increases.

Pre-crisis reform plans for old-age pensions brought forward. While pension payments were sometimes included in stimulus packages in the early phase of the crisis, they are now targets of fiscal consolidation (Table 1.3 and OECD, 2013i). A number of

Table 1.3. **Significant changes to the generosity or accessibility of old-age pensions**
Selected countries, 2009-13

	Pension age (a minus sign denotes *less generous* eligibility rules)	Contribution period (a minus sign denotes *less generous* eligibility rules)	Benefit level or indexation	Safety nets for elderly
Australia, 2009-10			+	+
Austria, 2010-11	-		-	
Belgium, 2012	-			
Chile, 2011				+*
Czech Republic, 2011-13	-	-	-	
Estonia, 2009-10	-		-	
Finland, 2010-13	-		+	+
France, 2010	-	-		
Greece, 2010-13	-	-	-	+*
Hungary, 2009-11	-		-	
Ireland, 2010-11	-		-	
Italy, 2011	-	-	-	
Netherlands, 2012-13	-			
Norway, 2011			-	
Mexico, 2013				+*
Poland, 2011	-	-	-	
Portugal, 2011-13	-		-	
Spain, 2011	-	-	-	+
Slovak Republic, 2011	-		-	
Slovenia, 2011-12	-	-	-	
Sweden, 2009			+	
United Kingdom, 2012	-	+	+/-	
United States, 2011			+	

Note: See notes to Table 1.1.
A "-" means less generous: stricter eligibility conditions, or lower benefit levels or indexation rules that became less generous. A "+" means the reform heads in the opposite direction and "+*" indicates a newly introduced programme.
Source: *OECD Pension Database* and OECD 2013 questionnaire on social policies in the crisis.

countries – e.g. Austria, Greece, the United Kingdom, and the United States – initially introduced one-off payments for retirees and these sometimes came on top of more targeted safety-net measures. New means-tested safety-net benefits for the elderly were introduced in Chile, Finland, Greece and Mexico. Australia and Spain have enhanced existing safety-net provisions for some or all low-income elderly. Iceland allowed early access to pension savings in order to support domestic demand.

In parallel, however, reforms also continued to address the structural weaknesses of pension provisions that became increasingly evident as GDP declined. More recently, pension reforms have focused either on immediately lowering public expenditure on retirement benefits or on restoring the long-term financial sustainability of pension systems by lengthening contribution periods. Measures that bring savings quickly include across-the-board benefit cuts, such as the abolition of the 13th and 14th monthly instalments in Greece, pension freezes, as in Austria, Greece, Italy, Portugal and Slovenia, or less generous indexation, as in the Czech Republic, Hungary and Norway. However, some countries, such as Australia, Finland and the United States, have altered the standard indexation mechanism to prevent benefit levels from dropping (indicated as a "+" in Table 1.3). Large benefit reductions were sometimes designed to protect smaller pension payments. For instance, successive reduction in Greece in 2010, 2011 and 2012 exempted pensions below EUR 1 200.

Many countries have sought to reduce costs and improve economic efficiency by raising retirement ages (most countries in Table 1.3) and by tightening early retirement conditions (e.g. Italy). Others, however, partially reversed earlier reforms. By early 2014, discussions were underway in Germany to lower retirement ages for specific groups, such as those with long employment histories. Several countries have partially or entirely diverted mandatory contributions to second-pillar private pension plans into public schemes (Estonia, Hungary, Poland and the Slovak Republic). Some of these reversals were introduced on a temporary basis (e.g. Estonia) while others are permanent (Hungary, Poland). Some involve a complete retreat from compulsory private pensions (Hungary) and others a partial change of the system (the Slovak Republic, Poland).

After long, rapid growth, health care spending at standstill since 2008. Unlike spending on social transfers, the rise in health expenditure had already come to a halt in 2008 across the OECD after long periods of rapid growth. In the fifteen years prior to the crisis, public and private health spending grew three times as fast as GDP. Between 2009 and 2011, it remained unchanged in real terms and it fell as a share of GDP on average (Chapter 6 "Health expenditure", see also OECD, 2013h). In a number of European countries, health care expenditure fell drastically, with Greece at 11% and Ireland at 7% making the greatest reductions. Other hard-hit countries – such as Iceland, Portugal, and Spain – also made cuts. Only Israel and Japan have accelerated their health care spending.

Some three-quarters of health care spending in the OECD is publicly funded, and much of the overall drop can be attributed to falling government expenditure, or to substantially slower expenditure growth. In the immediate aftermath of the economic slowdown, public spending on health was largely stationary – even in some of the worst-hit countries. From 2010, however, cuts became significantly more widespread. Countries that cut expenditures (like Ireland, Iceland, Estonia, and Greece), or where the growth in spending slowed significantly, reversed pre-crisis trends across all the main health care spending categories – in-patient, out-patient and pharmaceuticals.

Cost saving in health care is a daunting challenge because, if doing so compromises health outcomes, it will trigger even higher health care costs in the future (OECD, 2010b). Nevertheless, a few countries reformed their health care systems precisely to make short-term savings.

In the aftermath of the crisis years, countries made substantial changes to their health policies – even if it is not always easy to distinguish between measures taken in response to the crisis and previously planned structural reforms to contain health care costs. Policy responses varied across countries, but some general patterns can be identified (Vangool, 2014). Denmark, Germany, Poland, the Slovak Republic, and Switzerland had already planned to curb their public health care provision before the crisis. When it bit, however, they took swift, intensive action to implement their reforms. Countries like Australia, which have avoided deep recession, also introduced measures to make health care-related cost savings.

To achieve savings, countries have sought either to reduce the cost of health care services and products or to limit coverage. Many have restricted coverage by requiring income tests so that lower socio-economic groups retain their entitlements and the wealthy face higher costs. The Czech Republic and Spain, however, have curbed public health entitlements for undocumented foreign nationals. Many more countries (Australia, Austria, Belgium, France, Denmark, Estonia, Iceland, Ireland, Portugal) moved to require larger out-of-pocket payments. This affects low-income households although exemptions and caps can ease the impact on vulnerable groups; Portugal and Spain are among the countries that have taken action to that end.

Reducing the cost of public health care provision often involves cutting the wages of health care professionals or renegotiating pharmaceutical prices. A short-term focus on bringing down the prices of health care provision can help to maintain levels of service provision in the short run. But it can be contentious, nonetheless. For instance, in the longer run, wage-cutting policies may drive people out of the health care profession so creating staff shortages and compromising quality of service in the future.

Many OECD countries have undertaken more structural reforms to improve the efficiency of the health care sector, changing payment mechanisms, merging key institutions, and rethinking purchasing arrangements. Major structural reforms – such as the provisions of the US Affordable Care Act which first came into force in 2013 – are however often not directly related to the crisis or to short-term fiscal objectives. And even when they are, they are likely to require lead-in times before they have the desired effect and pay dividends of improved long-term efficiency, productivity, and coverage. Countries such as Greece and the Czech Republic are implementing output-based hospital funding mechanisms that have been shown to increase productivity in other countries. Stronger competition in areas such as community pharmacies may also provide greater responsiveness to consumers' needs and reduce prices.

Current fiscal measures have implications for wellbeing and social cohesion now and in years to come

Fiscal consolidation hampers progress in reducing inequality and poverty. Before the recession, fiscal policies, through taxes and social benefits, have played a significant role in reducing poverty and inequality in OECD countries. Previous work has shown that the redistributive effect of government expenditures and taxes acted as a significant "break" to the trend increases in inequality and poverty among the working-age population over recent decades (OECD, 2008b; Immervoll and Richardson, 2011). In the mid-2000s, taxes and transfers together reduced poverty by about 60% on average in the OECD (about 80% in Sweden and France, and 40% in the United States and Japan).

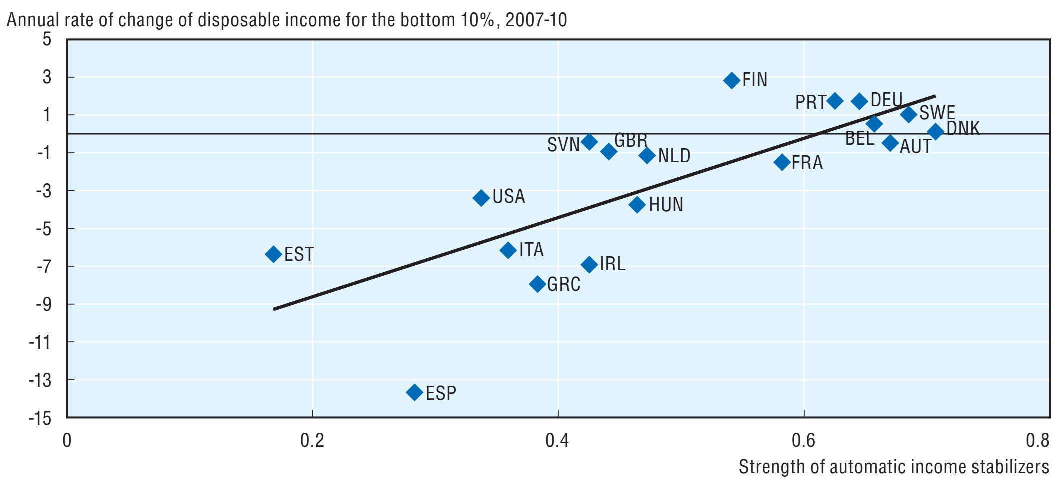
In most countries, social transfers contribute twice as much to inequality reduction as taxes do. However, since the mid-1990s, transfers in half of the OECD countries have in fact become less redistributive, largely as a result of falling benefit coverage among the working-age population. This has added to the long-term trend of rising inequality that was already apparent before the crisis (Immervoll and Richardson, 2011).

The patterns and mechanisms of redistribution discussed above prompt two important observations in a context of constrained social budgets:

1. It is very difficult to cut social spending – particularly transfers – without increasing inequality. A simple simulation, for example, reveals that cutting benefits in the same proportions across all income groups would widen income inequality significantly, while tax-based consolidation (a proportionate tax increase across all income groups) had the opposite effect (Rawdanowicz et al., 2013).
2. There is scope for strengthening existing targeting mechanisms – e.g. by ensuring that low-income jobseekers do not go without any support. Improving coverage of the neediest families should be a priority at a time when market incomes remain depressed and government support measures are being reviewed and often rolled back.

Countries with strongly redistributive taxes and transfers contained income losses in the early phases of the crisis as they were better equipped to provide automatic income stabilisation. As shown in Figure 1.17, the poorest 10% of households lost considerably more income in countries where automatic income stabilisers were weak. In these countries, tax reductions and higher benefits provide less income cushioning for those becoming unemployed or losing earnings. In some hard-hit countries with particularly large drops in disposable incomes of the poorest it is likely that automatic stabilisers were not operating at their full capacity (e.g. in Greece or Spain). Fiscal pressures may have led to cuts in income support through discretionary measures. Likewise, some of the groups with particularly high unemployment risks in these countries (e.g. young people or those losing their jobs after working on a non-standard employment contract) were not entitled to full income support and therefore did not benefit from any automatic stabilisers that provided support for other, less affected groups.

Figure 1.17. **Stronger automatic stabilisers were crucial in limiting income losses among the poorest**



Note: The "Strength of automatic income stabilisers" is a coefficient that shows how changes in market income translate into changes in disposable income. The higher the coefficient, the stronger the stabilisation effect – *e.g.* a coefficient of 0.4 denotes that 40% of the earnings shock due to higher unemployment is absorbed by the tax benefit system. The income changes are simulated based on EUROMOD (EU countries) and TAXSIM (United States) for an increase in unemployment of 5 percentage points.

Source: Chapter 3 "Household income" for income changes in the bottom 10% of the income distribution; Dolls, M., C. Fuest and A. Peichl (2012), "Automatic Stabilizers and Economic Crisis: US vs. Europe", *Journal of Public Economics*, Vol. 96, No. 3-4, pp. 279-294 ,for automatic stabilisers (using simulations based on tax and transfer systems that were in place before the crisis).

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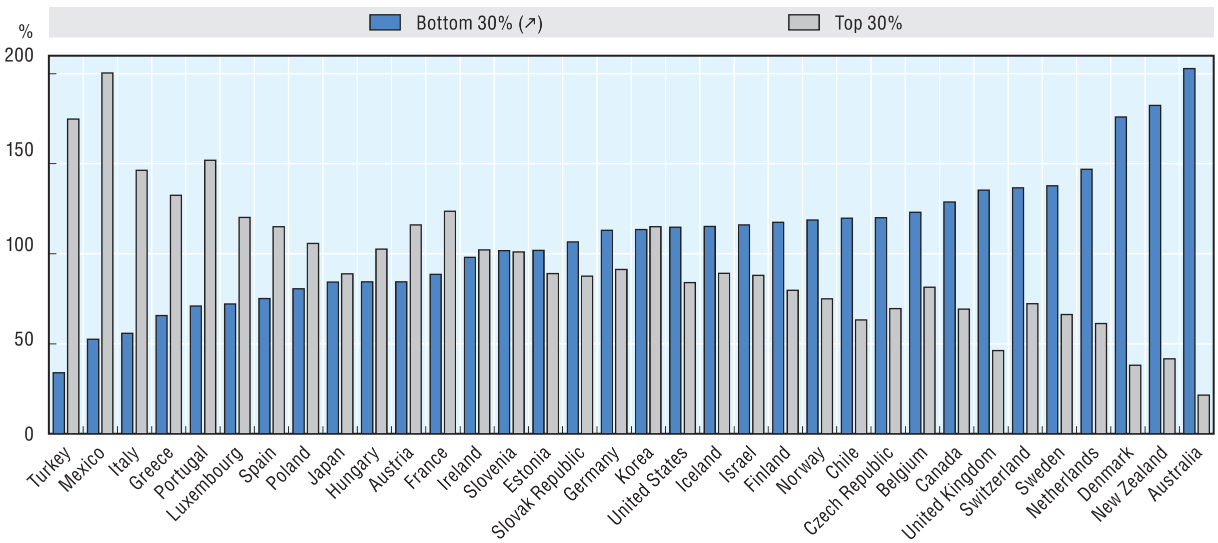
Pre-crisis trends in redistribution policies and income disparities can either moderate or reinforce the effects of fiscal consolidation (Immervoll et al., 2011; Jenkins et al., 2012). Where the redistributive capacity of tax and benefit policies had already weakened before the crisis (OECD, 2011), further consolidation measures may put income adequacy at risk.

Similarly, in countries where most transfers are already mainly received by low-income groups, cuts in transfer spending are much more likely to widen income inequalities. Figure 1.18 shows that transfers received by lower-income groups (the "poorest 30%") were close to double the average benefit payment in Australia, New Zealand and Denmark, and about 1.5 times the average in the United Kingdom, Switzerland, Sweden and the Netherlands. In these countries, reducing benefit spending without hurting low-income groups is more difficult than in countries providing significant income support across the income spectrum.

However, several countries that face particularly strong fiscal pressures in fact appear to spend *more* on transfers to well-off families (the "top 30%") than to low-income ones. This pattern – which is one factor behind structural fiscal deficits – is particularly strikin in

Figure 1.18. **When social transfers are highly targeted, spending cuts are more likely to hurt the poor**

Average total cash transfers received by low- and high-income groups, percentage of average transfers in 2010



Reading note: In Portugal, the average total transfer payment received by low-income families (in the bottom 30% of the income distribution) is 71% of the average payment across all families, and less than half of the average benefit payment received by high-income families, who receive 52% more than the average family.

Note: Transfers include all public social benefits. The reference year is 2009 for Hungary, Japan, New Zealand, Switzerland and Turkey. "Bottom 30%" and "top 30%" refer to average public transfers received by decile groups 1 to 3 and 8 to 10, respectively. Decile groups are determined in relation to household disposable income after accounting for taxes and transfers. All incomes and transfer amounts are adjusted for household size (see *www.oecd.org/social/inequality.htm*).

Source: OECD Income Distribution Database, www.oecd.org/social/inequality.htm.

StatLink http://dx.doi.org/10.1787/888932966200

Italy, Greece, Portugal, Spain, and, to a lesser extent, in France. In these countries, there is scope for lowering transfer spending without weakening redistribution and for shifting additional resources towards support for the poorest families.

An additional factor should be considered when weighing the benefits and costs of reduced social spending. Structural reforms in recent years have made social protection programmes significantly more employment-friendly. Examples are the introduction of measures to "make work pay" or to help reconcile work and family life. Insofar as countries have successfully reformed social protection in ways that encourage rather than hinder employment, cuts in social spending can now be expected to have a more adverse effect on poverty, inequality, and growth than in the past.

Who loses most from fiscal austerity measures?. Across all countries, rolling back inequality-reducing policy measures is bound to magnify income disparities in the short term. (By the same token, fiscal consolidation measures on the expenditure side also restrict room for manoeuvre in tackling the well documented medium-term trends towards rising inequality across OECD countries.) The opposite holds true of increasing progressive taxes. This is simply a "mechanical" consequence of the distributional profiles of taxes and transfers and establishing it does not require sophisticated analyses of historical data.

The precise economic consequences of fiscal consolidation measures are however the subject of an on-going, and still evolving, debate. In part, the controversy comes from the use of different outcome measures. A primary concern is the severe and immediate income difficulties that the crisis has brought onto families and most studies have therefore focussed the attention on the short-run effects of fiscal consolidation. But the full consequences of consolidation measures typically show up only after a number of years – the cumulative impact of consolidation on income inequality, for example, has been found to peak only after five to six years and fades by the tenth year (IMF, 2012a).

A second reason for the on-going debate is that some studies are interested in the impact on inequality, while others are mainly concerned with growth. From a social policy point of view, both dimensions are important, as tackling poverty and inequality is fraught with difficulty when the economy contracts or growth is weak. Indeed, stronger economic growth is a requirement for financing redistribution measures, reducing unemployment, and strengthening incomes at the bottom of the distribution.

On balance, the main lessons from recent authoritative studies based on data from earlier economic cycles point to four main conclusions (see Box 1.3):

1. In the medium term, fiscal consolidation appears to damage growth – a finding that applies particularly firmly to consolidation programmes enacted during downturns or fragile recoveries, and when consolidation efforts get underway simultaneously across several countries.
2. Spending cuts appear less damaging (or more beneficial) to medium-term GDP growth than tax-based consolidation. However, there is lingering uncertainty over such findings, as the measured effect may actually be due to other policies that are undertaken at the same time (such as monetary easing).
3. Any GDP losses resulting from fiscal consolidation are not shared equally. Labour incomes appear to fall substantially more strongly than profits or rents, and losses suffered by workers also persist for longer.
4. In line with the "mechanical" effect of fiscal savings measures, analyses of past consolidation programmes tend to find that spending cuts increase inequality more than tax increases (Woo et al., 2013). Tax increases' effects on inequality in particular depend on the type of tax increased – whether it is direct or indirect, for example.

Box 1.3. **Fiscal consolidation, inequality and growth: An on-going and evolving debate**

Although fiscal adjustments have an impact on economic outcomes, economic outcomes also affect the size of fiscal adjustments. The correlation between the two cannot therefore be viewed as a cause-effect relationship that operates in any one direction. The standard approach to solving this problem is to statistically separate changes in fiscal balances from (other) economic changes (Alesina and Adragna, 2012).

Along these lines, Agnello and Souza (2012a) find that successful fiscal consolidation episodes – defined as those that bring public debt down to a lower level within three years – may actually reduce income inequality. Their study draws on a long data series for 18 OECD countries covering consolidation periods between 1970 and 2010. However, in a more detailed analysis the same authors show that the impact on income inequality depends on the size and make-up of fiscal consolidation policy, with adjustments based primarily on large spending cuts leading to rising inequality (Agnello and Souza, 2012b). Inequality rises when consolidation is modest (below 1% of GDP) and spending cuts exceed 0.8% of GDP. By contrast, inequality falls if taxes rise by more than 0.6% of GDP.

Alternatively, fiscal consolidation episodes can be identified directly from policy documents to ensure they are not simply responses to the economic cycle – the so-called "historical" approach. This line of research tends to confirm that adjustment costs are not shared equally and fall mostly on lower-income groups. Drawing on 173 episodes of consolidation in 17 OECD economies over the past 30 years, Ball et al. (2011) find that wage

Box 1.3. **Fiscal consolidation, inequality and growth: An on-going and evolving debate** *(cont.)*

earners lose out more: for every 1% of GDP of fiscal consolidation, wage income typically shrinks by 0.9%, while profit and rents fall by only 0.3%. The decline in wage income also tends to be more persistent, particularly due to increased long-term unemployment, and labour-market inactivity.

Short-term effects, which include any adverse impact on inequality, are a primary policy concern in countries where lower-income groups suffered significantly during the downturn. But there is a parallel debate on the relative merits of tax- and spending-based consolidation strategies with regard to subsequent economic growth.

- Alesina and Ardagna (2010, 2012) find that fiscal adjustments based on spending cuts are less likely to be reversed than measures that rely primarily on tax rises, that they have a less detrimental effect on economic activity, and that in combination with other policies they may be associated with stronger economic growth in subsequent years. The main mechanism underlying the findings is that a decline in public spending without significant increases in taxes stimulates private domestic demand in the short term. This is the "expansionary austerity hypothesis".
- However, the "historical" approach described above tends not to support the expansionary austerity hypothesis. Actually, spending-based adjustments do appear less contractionary than those that are tax-based, particularly after the first year. This, however, stems primarily from the difference in monetary policy responses, with central banks easing their policies more often in support of spending-based adjustments. In addition, some of the spending cuts in earlier downturn episodes took place in a more favourable economic context, which probably helped to reduce any damaging effects on longer-term growth (Guajardo et al., 2011).
- In new work that adopts a more refined statistical approach, Jordà and Taylor (2013) confirm that fiscal consolidation damages medium-term growth. They go further, however, and look at the crucial question of timing. Results indicate that damage to growth is more likely if consolidation takes place pro-cyclically at a time when growth is *already* weak, and that particular care needs to be exercised when implementing savings measures during or shortly after a deep downturn. This type of result is also consistent with studies indicating that government spending has larger expansionary effects in recessions than in periods of expansions (e.g. Auerbach and Gorodnichenko, 2012). In addition, growth tends to fall more markedly if consolidation efforts get underway simultaneously across several countries as they create negative "spillover" effects via international trade channels (Goujard, 2013).
- In addition to the question of timing, important further distinctions need to be made according to the specific policy measure being taken. For instance, OECD (2013k) draws on existing empirical work to argue that such distinctions need to go beyond spending-based versus revenue-based consolidation. For instance, they illustrate that increasing (progressive) personal income taxes damages long-term growth, but reduces inequality, whereas the opposite pattern holds true for (largely regressive) indirect tax raises.
- Generally speaking, carefully balanced offsetting measures – such as higher tax progressivity and targeted cash benefits – can limit any negative effects of consolidation on inequality. Beyond direct redistribution through taxes and transfers, there is evidence that longer-term trends in both equality and growth can be promoted by ensuring adequate resources for ALMPs and education for low- and middle-income workers (Woo et al., 2013).

The consequences of fiscal adjustment for household income therefore depend not only on the extent of fiscal measures but, crucially, on their design and timing. Simulations based on household data can provide deeper insights into the distribution of consolidation burdens across different income groups. While the backward-looking studies mentioned above paint a useful "big picture", micro-simulation studies are valuable for the way they identify the effects of very specific policy measures – they can, for example, go beyond the very crude distinction between spending-related and tax-based consolidation measures.

Avram et al. (2013) use the simulation approach to estimate the impact of actual fiscal packages in Estonia, Greece, Italy, Portugal, Spain, and the United Kingdom. Although it is difficult to account in a realistic way for possible consolidation-induced changes in labour market behaviour, the study gives a sense of the most relevant distributional mechanics of recently enacted reforms and of their immediate impact on household incomes. Results confirm that the distribution of adjustment costs between income groups depends heavily on the details of fiscal packages and on population characteristics. As might be expected, spending cuts made between 2010 and 2012 typically weigh more heavily on the bottom income groups, while tax increases have mostly affected higher-earning families.

Overall, the early consolidation measures analysed by that study seem to have been borne mainly by upper-income groups – largely because most means-tested benefits were protected from early cuts, while progressive taxes were increased. There are, however, wide differences between countries, and accounting for significant increases in typically regressive indirect taxes could change the overall conclusion (European Commission, 2013a). Also, consolidation efforts that came into effect after the study's 2012 cut-off would change the combined effect of consolidation measures. For instance, more recent tax and benefit reforms implemented in the United Kingdom in 2012-13 were found to produce disproportionate income losses among families in the bottom half of the income distribution (Joyce, 2012).

3. Can social policies be made more crisis-proof?

Crisis "readiness" is not just about spending levels

Ensure essential support for the least well-off: benefits and costs of targeting

Reforms to cash-transfer policies and social and health care services should make protection of the neediest their priority. Across-the board cuts are not compatible with the important global agenda of ensuring effective social protection floors (ILO and OECD, 2011). Fiscal consolidation measures should steer clear of indiscriminately cutting supplementary benefits such as housing and child/family support which may be vital to poor working families and lone parents. Reducing benefit levels directly, as in Ireland, or progressively through de-indexing, as Finland, the Netherlands and the United Kingdom have done, does create savings. Such an approach, however, needs to treat the most vulnerable families differently in order to avoid poverty and long-term ill-effects on children's well-being.

As long-term unemployment spreads, accessible, adequate assistance benefits have become crucial for averting steep rises in poverty and inequality. The central role of assistance benefits as fall-back options for those who are not or are no longer entitled to unemployment support should be reflected in the design, timing, and implementation of necessary fiscal consolidation strategies. Indeed, well-targeted safety-net benefits are more cost effective than other measures – such as expensive and difficult-to-target price subsidies for food or energy – that also aim to help households to make ends meet. Cash benefits should continue to adequately support families in hardship, while minimum income benefits should be made more accessible where unemployment and poverty remains high and those affected have little access to other forms of support.

Greater means testing could help target and protect the most vulnerable while reducing benefit expenditures. However, work disincentives associated with tight targeting of low-income families income are likely to become a more significant concern once labour demand starts to pick up during a recovery and people's labour supply decisions become a more powerful determinant of employment levels. Means-tested programmes can also be difficult to roll out quickly and often suffer from low benefit take-up. As a result, it can be difficulties to reach the most vulnerable groups, and coverage of targeted populations can be low.

Targeting *behaviour or non-income characteristics* is an alternative that can save costs while leaving incentives intact. In the context of fiscal consolidation, adequate administrative and operational resources are, however, required to effectively implement targeting measures.

- Broad indicators of deprivation, such as those that many countries use for determining eligibility for social housing, could be a good basis for effectively targeted services or in-kind transfers. These deprivation indicators can be a more reliable metric of living conditions than income. They are also less volatile and do not compromise short-term work incentives.
- Some forms of conditional cash transfers, such as those pioneered in Mexico and Brazil, can in fact create positive externalities by promoting beneficial health and educational outcomes (Fiszbein and Schady, 2009).
- When support is directed at children, it can help to ensure more equal opportunities and reduce the likelihood that poverty is transmitted from one generation to the next. For instance, subsidised or free school meals exist in a number of OECD countries, including France, the United Kingdom, and the United States (Richardson and Bradshaw, 2012). In hard-hit countries, such as Greece, they should be considered as one element in strategies to reduce the negative long-term consequences of increasing economic hardship.
- The concept of "mutual obligations" makes benefits conditional on claimant behaviour and aims to restore self-sufficiency and prevent long-term benefit dependency. A stricter enforcement of job-search and other work-related conditions is controversial and difficult to implement when labour markets are very weak and greater job search may not produce the desired effect. As more job vacancies are posted during a recovery, there is however a strong case for linking benefit receipt more tightly to job-search or availability-for-work requirements.

Efficient public or private services are essential to delivering good social policy

Services are an integral part of support for vulnerable groups, such as children in disadvantaged families, jobseekers, people with health problems, or groups facing extreme economic hardship. The public provision of services, or the public funding of private provision, is also an effective way of making important aspects of life less dependent on income.

Governments should consider whether structural reforms in public service delivery can save costs and increase efficiency. However, because service provision needs to be efficient in its utilisation of inputs and delivery of outputs, it is equally important that they also look at whether essential services meet demand. More broadly, debates of public expenditure cuts should critically examine the impact that such cuts have on service users.

Service cuts are problematic when large numbers of people can no longer afford market-based services or when trying economic conditions increase the demand for public services. Reducing staff levels in labour-intensive services impairs their effectiveness: at public employment offices jobseekers may not get the person-to-person support they need, for example, and understaffed childcare centres will lack capacity, making it harder for parents to resume work. Similarly, cuts to education budgets affect skills development and school environments and may swell future youth unemployment. Where possible, governments should seek to reduce costs while protecting the delivery of essential services, for instance by redeploying staff from lower-priority activities to areas of greater need.

Lower spending on service provision may not translate into overall savings if reduced capacity and quality increase the demand for cash support or for services in other areas. For instance, lower funding for homeless shelters may redirect support seekers to much more costly hospital services. There is also evidence that a good public service provision helps to keep prices low, while cutbacks may trigger price hikes and rising demand for cash support (Cunha et al., 2013). Similarly, scaling back service infrastructure does not produce longer-term efficiency gains if significant human or institutional capital is lost in the process. There may be trade-offs between quick cost-cutting fixes (such as budget ceilings or envelopes) and measures to improve long-term efficiency – especially in services for which demand will rise in the future, like long-term care, or which support an economy's productive capacity, such as childcare.

Service cuts are typically not easily reversed. Temporary reductions in service capacity may eventually lead to higher costs than temporary changes to cash transfers or taxes, as staff need to be rehired or retrained or infrastructure rebuilt. Finally, if service delivery is highly decentralised, savings measures instituted at different levels of government may give rise to considerable co-ordination challenges – especially in federal countries, even though all countries devolve service delivery to some extent.

Prioritise funding in investment-type programmes, especially for children and youth

In some areas of social spending, there is strong evidence of distinct long-term benefits which should inform decisions on how to share savings efforts across the health and social-protection budgets. Good quality health care and effective income safety nets are not only crucial for safeguarding individual well-being, but also to maintain the capacity and productivity of the current and future workforce.

Any savings measures should take special care to factor in the increased health care needs arising from the crisis. It is well-documented, for instance, that unemployment is detrimental to mental health (see the discussion in Section 1). Although mental health problems often become chronic, most of them can be treated, symptoms reduced and conditions stabilised (OECD, 2012c). Yet, even when the economy is robust, one of the biggest challenges for the health system is the high rate of under-treatment of mental illness. A lack of effective prevention, diagnosis, and treatment for groups at risk of poor mental health translates into significant social and economic costs later on.

Similarly, governments should prioritise social support for children and youth – particularly during the formative years of early childhood and the transition from school to work. While poverty is a concern in itself, it also has damaging long-term consequences, particularly its "scarring" effects on children. These "scarring" effects of low-income spells mean that when the recession ends, its impact on children do not. Ensuring that the basic needs of children and youth are met can therefore be one of the most important social investments and should be a central pillar of social protection.

Governments need to take swift action to address the widely observed increase in youth poverty and joblessness. A number of countries, like Portugal, have introduced support measures for unemployed youth, while others – such as the United Kingdom, Denmark, and New Zealand – have implemented comprehensive strategies to offer a way forward to all young people who are neither in employment, education, or training. The principles underlying the European Union's Youth Guarantee scheme and the OECD Action Plan for Youth go in the same direction.

Under the European Youth Guarantee, EU member states make all under-25s a tailored offer – for a job, apprenticeship, traineeship, or continued education – within four months of their quitting formal education or becoming unemployed. Ideally, cash transfers for young people should be conditional on young people taking up the offers made to them, and should include access to affordable health care (see recommendations in OECD, 2013c). Implementing these strategies will require planning – and financing – additional infrastructure and training capacities in the short term. But if carefully designed and implemented, it should boost employment rates and lower dependence on social transfers throughout adult life.

Provide accessible employment support adapted to the labour market situation

Government support should harness and supplement – rather than substitute – the ability of households to adjust to troubled circumstances. Finding alternative earnings opportunities is no easy matter in the depths of a recession. But the evidence shows that even in such trying times there is considerable hiring – in the order of 15% of total annual employment (OECD, 2009) – and that firms in some sectors grow while others reduce staff levels or close.

The high fiscal cost of joblessness reinforces the case for well-funded active labour-market policies (ALMPs), even if they are costly in the short term. While ALMPs account for a small share of public expenditures, spending in this area nevertheless has a crucial bearing on fiscal consolidation as successful employment support policies boost growth and reduce other social expenditures. Weak labour markets, coupled with the need to tackle large fiscal imbalances, have renewed interest in the role of activation policies that promote the (re-)integration of jobseekers into employment.[14] When fewer vacancies complicate the task of effectively matching jobs and jobseekers, there are, more than ever, sound arguments for making adequately resourced, suitably designed active labour market policy a priority (Immervoll and Scarpetta, 2012).

Governments should maintain labour market activation strategies and suitably designed in-work support at a reasonable level – including for part-time workers. When the number of jobseekers grows during a downturn, a prime focus for governments should be to ensure adequate resources for public employment services and benefit and programme administration. These services act as "gateways" to programmes such as training and job-search assistance. Maintaining effective service capacity is crucial for avoiding inappropriate and inefficient assignments of unemployed persons to costly labour-market programmes. To address these challenges, Australia, Denmark and Switzerland automatically adjust budgets for active labour market policies in line with labour-market conditions (OECD, 2009). Similar provisions should also be considered in other countries in order to protect this crucial area of social spending during times of fiscal restraint.

However, how ALMP resources are allocated and used is as important as how much is spent on them overall. The best combinations of policies are those that meet labour market conditions and jobseeker needs, both of which generally change significantly over the course of a downturn and into recovery. As a recovery gains momentum, more vacancies are posted, and active job-search becomes a more decisive factor for employment outcomes, policies should shift from labour demand to activation and in-work support for low-income working families. The type, sequence and intensity of activation measures should be continually reviewed and adapted to evolving labour-market challenges, while fiscal constraints may require a rapid transition from wide-ranging stimulus packages to selective, customised employment support.

Policy changes in other areas may also require reviews of activation strategies. Generally, when benefit provisions are altered, this typically also shifts the balance of "mutual obligations" which underlies the relationship between claimant, benefit administrations and employment services. Unemployment benefit extensions, for instance, should go hand in hand with adequate resources for effective job-search services and employment support. To ensure that the focus stays on re-employment, governments should consider "soft sanctions" such as requiring claimants to re-apply for benefit extensions, introducing waiting periods between consecutive claims, or reducing benefit amounts over time.[15]

Moreover, as the number and profiles of jobseekers changes, governments should monitor whether back-to-work policies continue to target and prioritise the intended groups. Activation measures and support for recipients of lower-tier assistance benefits become, for instance, more important as people exhaust their unemployment insurance or where many unemployed do not receive insurance benefits in the first place.

If support services do not have the capacity to serve everybody, then authorities need to make difficult choices. The best track may be to prioritise those who are, in some sense, closest to the labour market as they hold the best prospects for returning to employment. However, people who are essentially job-ready may in fact not need intensive public assistance to find work. Instead, a more urgent priority may be to focus on those most in need of support services and intensive case management. The best targeting strategy depends on available resources, on the types of activation and employment support measures that are available, and on the specific employment barriers faced by the different groups of jobseekers.

Reinforce household resilience and encourage support between family members

Successful active social and labour-market policies should, as much as possible, factor in the family situation of jobless individuals. To date, policy responses to the crisis have concentrated on *individual* job losses and circumstances while frequently ignoring household and family context. However, when there are large numbers of workless households (see Figure 1.15 above), back-to-work and in-work support should not be restricted to individual job losers, but include partners and all working-age family members (even if they are not registered as unemployed). Policies that strengthen work incentives and support for the partners of primary earners and jobseekers are cost-effective as second earners' employment decisions are known to respond strongly to such measures.

Households where both partners work, have work experience, or are actively looking for a job are in a better position to minimise income losses in the event of unemployment. They are also likely to benefit more quickly from improving labour-market conditions. However, it is in fact not clear whether a recession strengthens or weakens the so-called "added-worker" effect – where spouses compensate for some of their partners' loss of earnings by starting employment or working longer hours. On the one hand, accelerating job losses, less stable employment patterns, and reduced working hours clearly increase families' need to make up for falls in income. On the other hand, the weak labour market makes it harder to do so.

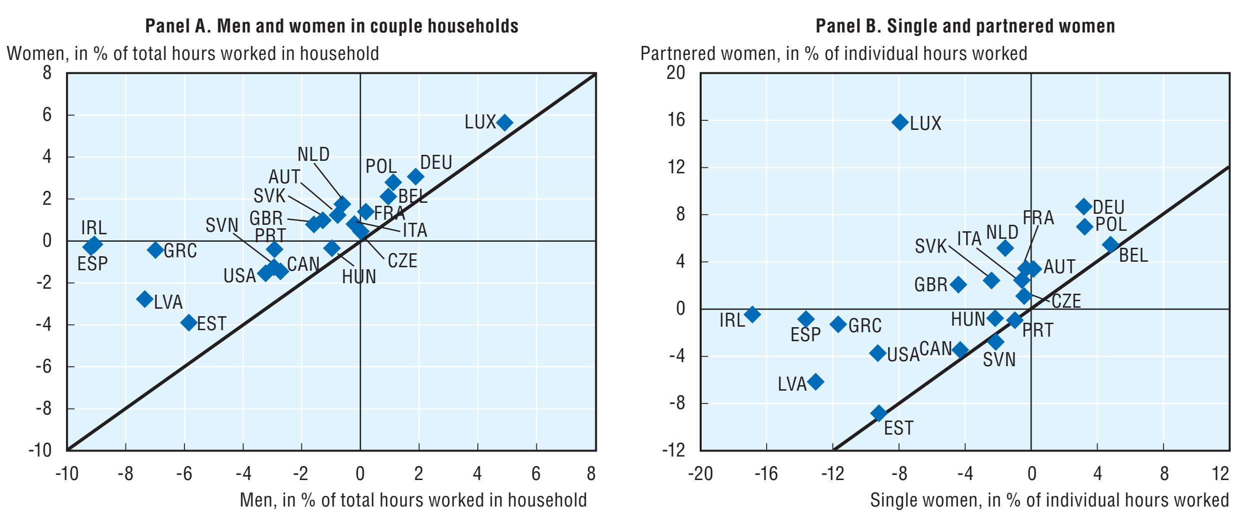
The objective of strengthening families' ability to absorb and offset temporary earnings losses has brought gender into play, as more women now have labour-market experience than in previous recessions. This, and the fact that men have suffered significantly greater job losses in the OECD area, has increased the chance that women will be able to compensate for some of their partners' earnings losses through the added-worker effect.

New labour-market data show that female employment has in fact been an important factor in limiting economic hardship in families (Figure 1.19). Between 2007 and 2011 job losses and reduced working time among partnered men lowered *total* working hours of couples (i.e. the number of hours worked by both partners in all couple families in the country) – by some 3% in Canada, Portugal, Slovenia, and the United States, and by between 6% and 9% in hard-hit Estonia, Greece, Ireland, Latvia and Spain (Figure 1.19, Panel A). Although women's unemployment rates also rose, their total working hours fell less than men's – and often went up – in all the countries shown. For women who already worked full-time, working significantly more was not an option. Many women work part-time, however, which yields considerable scope for increasing total working hours even in countries where their employment rates were comparatively high, such as in France and the Netherlands.[16] Partnered women were more likely to work more (or less likely to see their hours reduced) than single women (Figure 1.19, Panel B). Although this pattern is not conclusive evidence of an added-worker effect, it is plausible that their partner's earnings loss was one of the factors driving women's additional hours of work.

Policy factors explain in part why women in some countries increase their working hours more than in others. The need to do so may be perceived as less pressing if men's earnings losses are temporary (due to short-time working schemes, for example) or largely

Figure 1.19. **Women's employment greatly improves families' resilience to economic shocks**

Change in total hours worked by men and women, 2007-11



Note: Changes are relative to family pre-crisis hours (i.e. the sum of men's and women's hours) in Panel A, and relative to individual pre-crisis hours in the different groups in Panel B. Changes in total hours capture differences in both employment levels and hours worked.

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

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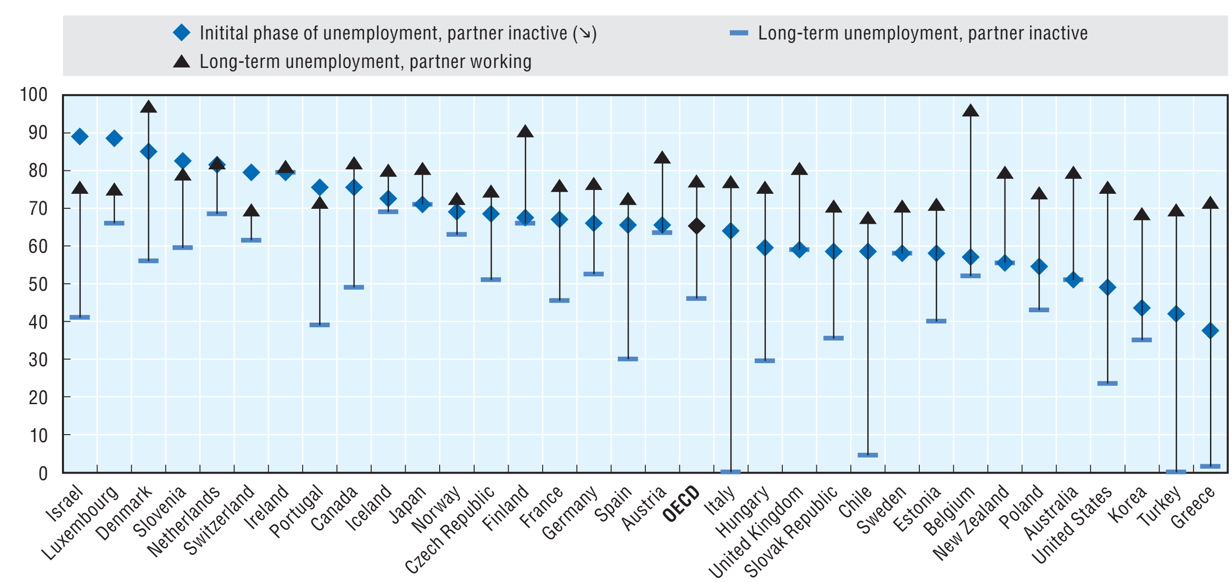
offset by government transfers. In addition, disincentives created by tax breaks and out-of-work benefits can affect the job hunting and work commitment not just of a household's principal earner but of its second earner, too. Even though people entitled to means-tested benefits generally have very low incomes – and therefore stand to gain substantially from the added-worker effect – benefit reductions that kick in as soon as a family member works or earns more are a barrier to a household enjoying a stable income.

In most OECD countries, families with one long-term unemployed member are much better off when his or her partner finds employment, even if it is relatively low paid (Figure 1.20). However, Figure 1.20 also shows that some tax-benefit systems do little to accommodate added workers. In Luxembourg, the Netherlands, Switzerland, Iceland, Japan, Norway, and Sweden, for example, a relatively high tax burden of the spouse taking up employment, and/or reduced benefits as a result of family means testing limit the income gains from an added-worker effect. Countries should consider giving added support to the partner making the transition into employment in the form of childcare support, for example, or carefully designed back-to-work allowances that benefit not only registered jobseekers, but their partners too. Finland has recently changed the means test for unemployment assistance benefits along these lines, by ensuring that employment of one partner does not reduce benefits of the other (see Table 1.1). However, some reforms that are aimed at helping workless households – such as "bonus" payment for families where both parents are unemployed (see Table 1.1 for examples) – could discourage active job search if benefits are withdrawn too quickly once a family member starts to work.

In general, policies that address gender-specific employment barriers strengthen families' resilience to economic shocks and improve their prospects of benefiting from a recovery (OECD, 2012b). At the same time, however, households are shrinking, with

Figure 1.20. **A working partner makes family incomes more resilient to income losses**

Net incomes at different sages of unemployment, with and without a working partner, percentage of in-work income, 2011



Note: Incomes are shown for a married couple with one unemployed spouse (previously earning 100% of the country's average wage) and the other spouse either labour-market inactive or working and earning 67% of the average wage. Percentages relate to the family's net income before the primary earner became unemployed. Net incomes include unemployment benefits, as well as any minimum-income or family-related benefits that are available. Results are averages over two family situations: a married couple with and without children.

Source: OECD Tax-Benefit Models, *www.oecd.org/els/social/workincentives*.

StatLink http://dx.doi.org/10.1787/888932966238

growing numbers of single-person and lone-parent families and fewer multigenerational ones. Single-person households obviously face a complete loss of earnings in the event of unemployment, while lone parents may find it particularly difficult to adjust to income shocks because of their childcare obligations and restricted mobility. Such constraints point to the crucial need for governments to continue providing lone parents with child benefit and employment-friendly tax-breaks across the economic cycle.

Enable labour-market adjustments through employment-friendly regulations

Labour market regulations should protect workers but not hinder the creation of new jobs. Deep recessions typically produce sizable sectoral shifts in the economy. In the countries most affected by the Great Recession, hard-hit sectors like construction and manufacturing will often not regain their pre-crisis employment levels. Recessions and subsequent recoveries also lead to substantial numbers of job transitions within sectors – e.g. when firms that had shed personnel in response to faltering demand start to rehire. Regulations that make it costly to hire new workers slow down or inhibit the dynamic job creation that is needed for a swift labour market recovery. When vacancies cannot be filled, this leads to longer periods of unemployment, and a poor match between job requirements and a worker's skills and aspirations.

With disadvantaged workers bearing the brunt of job and earnings losses during the on-going crisis, concerns over labour-market inequality have become more pressing. Governments in several countries have taken positive steps towards fostering under-represented groups' access to employment and address labour market segmentation and discrimination. Recent reforms in this area need to be seen as a response to policy trends initiated in the 1990s, such as the deregulation of temporary contracts. This unbalanced deregulation heightened labour market duality between growing numbers of temporary workers, or "outsiders", who cycle between temporary contracts, and "insiders" on open-ended contracts who enjoy a high degree of employment protection and greater job stability.[17] Partly as a result of dual or highly segmented labour markets, disadvantaged workers in Southern Europe experienced particularly steep job losses during the recession (Carneiro et al., 2013). Facilitating their reemployment in better-quality jobs is a priority and labour-market reforms have been high on the policy agenda, particularly in a number of Southern European countries.

Since the onset of the financial crisis, more than one-third of OECD countries have relaxed regulations governing individual or collective dismissals. The most far-reaching changes have generally come in countries which had the most stringent regulations before the crisis, such as Greece, Italy, Portugal and Spain (OECD, 2013b). Greece and Portugal have made severance pay less generous and shortened notice periods. In Portugal, an important plank in the country's reform to support young workers is the abolition of the need for redundancies to proceed by age, with the most senior workers laid off last. Italy has reduced legal uncertainty on the employer side by restricting the grounds on which courts can order reinstatements to severe cases of wrongful dismissal, such as discrimination. Italy and Spain have also streamlined dispute resolution procedures and Italy has abolished provisions that allowed employers to terminate certain atypical contracts at will.

In early 2012, Spain enacted a labour market reform to address some of the main causes of dual labour markets (OECD, 2014a). The reform provides firms with alternatives to layoffs when product demand is weak (e.g. giving them greater scope for renegotiating wages and working time), halved notice periods, reduced monetary compensation for unfair dismissal, simplified administrative procedures for mass (or "collective") redundancies, and introduced a new, less regulated employment contract for small firms with fewer than 50 staff. In France, a 2013 reform of the labour code relaxed regulations on regular (open-ended) contracts, introduced an additional payroll tax applicable if fixed-term contracts are not converted to open-ended ones at the end of the fixed term, and allowed social partners – in times of serious company difficulties – to negotiate temporary firm-level agreements on wages and shorter working times in exchange for job guarantees.

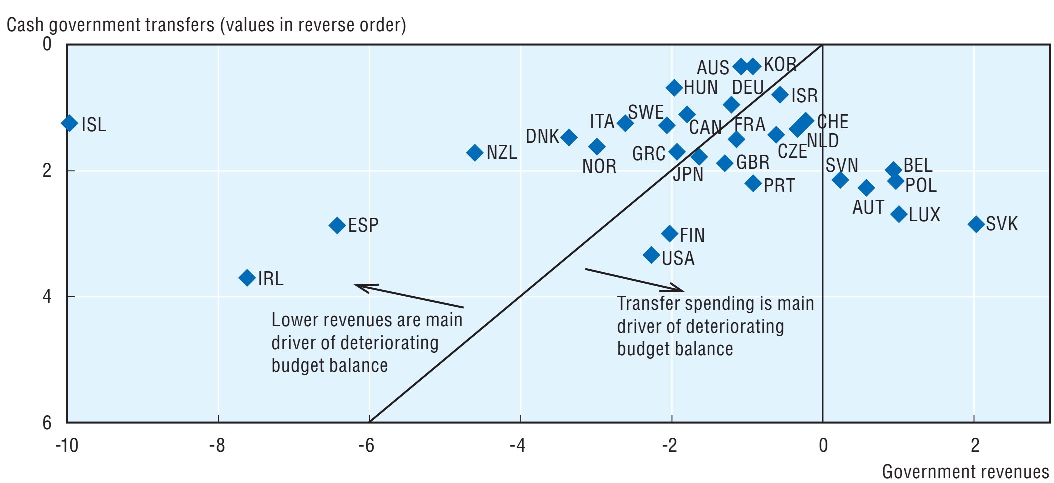
Adequate resources for counter-cyclical support measures

Ensure fiscal measures are carefully timed and balance measures on spending and revenue sides

The fiscal crisis is not just a spending crisis. Recessions cause slumps in a range of revenue sources and a possibility of extended periods of sluggish revenue growth. During some phases of the Great Recession, reduced government revenues in many countries have consequently had greater impacts on budget balances than inflated benefit expenditures. For instance, if 2010 revenues in Spain had been the same as in 2007 in real terms, this would have reduced the budget deficit by more than 6 percentage points (Figure 1.21). Returning to 2007 benefit expenditure levels would have narrowed the deficit as well, but by much less (3 percentage points).

Figure 1.21. **Budget deficits after the initial downturn: role played by changes in transfers and revenues**

Changes in benefit expenditure and revenues as percentages of 2010 GDP, 2007-10



Reading note: If 2010 revenues in Spain had been the same in real terms as in 2007, the country’s budget deficit would have been more than 6 percentage points smaller. Returning to 2007 benefit expenditure levels would have reduced the deficit by under 3 percentage points.

Note: Changes in both transfers and revenues are measured in real terms (in 2010 currency). The vertical y axis is inverted (a positive number indicates an increase in social benefit expenditure and a worsening budget balance). Government transfers: all cash social benefits paid by government. Government revenues: total tax and non-tax receipts of the general government sector (central and sub-central) plus social security contributions.

Source: OECD (2011), “Economic Crisis and Beyond: Social Policies for a Recovery”, Background document for OECD Ministerial Meeting on Social Policy, 2-3 May, OECD, Paris.

StatLink http://dx.doi.org/10.1787/888932966257

Revenue-side measures have an important role to play. Both historical income trends and recent data signal sizable shifts in relative “tax capacity” from lower- to higher-earning groups in the aftermath of steep downturns. Governments should factor those shifts into tax measures that seek to balance revenue needs with distributional concerns such as the very unevenly shared benefits of economic growth, both before and since the crisis, and the very large income gains of top earners in some countries (Förster et al., 2014). Like expenditure cuts, tax measures should be designed, timed, and targeted carefully so as to avoid choking off the fragile economic recovery. Moreover, revenue requirements are such that tax increases in any one area are unlikely to be sufficient to close the revenue gap. The consolidation efforts of recent years have focused mostly on income and consumption taxes. Governments should now consider action such as tackling evasion and avoidance, shifting tax burdens away from labour (particularly low earners) to broad-based consumption and also residential property (European Commission, 2013b; IMF, 2013; LeBlanc et al., 2013). Addressing tax policy challenges, broadening the tax base, tackling tax avoidance and reducing labour tax burdens for low-income groups in particular could also help the resumption of growth and make revenues less volatile during the economic cycle.

A need for counter-cyclical policies

Governments find it hard to build up savings. This difficulty can be explained by political considerations (Alesina and Tabellini, 1990; Amador, 2003), and is strikingly illustrated by the fact that many OECD countries ran budget deficits in most or all years in the past three to four decades. One risk of a long-term rise in government debt is that a combination of increasing debt-servicing costs and spending increases for old-age support reduce the room for redistribution and investment-related social policy measures targeted at children and working-age individuals (Streeck and Mertens, 2013; Immervoll and Richardson, 2011). The failure to address fiscal misalignments during economic upswings creates strong pressures to consolidate in a pro-cyclical manner (i.e. during a downturn or periods of low growth), which risks delaying and slowing the recovery (see Box 1.2). Indeed, a recent IMF study of 17 OECD countries confirms the pattern of pro-cyclical consolidation and points out that large fiscal adjustment programmes have almost always taken place in the context of “initially weak [macro-financial] fundamentals” (Dell’Erba et al., 2013).

Counter-cyclical support is needed for two reasons. First, because the objective need for support is greater during and after a downturn (equity argument). And second, because economic upswings alone are unlikely to undo the damage inflicted by recessions, e.g. because income losses suffered during downturns become entrenched. Counter-cyclical social policy is then an efficient use of public funds and can increase total welfare by reducing future social and economic costs (efficiency argument). Spells of poverty and unemployment give rise to longer-term scars and there is in fact overwhelming evidence that scarring does lead to lower future employment and earnings, and also negatively impacts a range of other important outcomes, including health.[18] When scarring is substantial, rising poverty and unemployment during and after a downturn strengthens the case for redoubling social policy efforts.

OECD countries have used counter-cyclical social policies of different types and to different extents, and these differences offer pointers as to how policies could be made more responsive to changing economic conditions and to household needs. For instance, countries such as France, Portugal and the United States, have actively extended out-of-work benefits at the onset of the crisis, and most countries with strong out-of-work benefits in place have allowed them to operate to the full extent by keeping them accessible to a rapidly growing number of jobseekers and so helping to stem income losses (see Figure 1.17 above).

Some of the worst-affected countries in Southern Europe, however, were ill prepared for the social consequences of the crisis. Their social protection arrangements were weak and discretionary policy measures did not significantly strengthen support for such hard-hit groups as the long-term unemployed or people with little or piecemeal work experience. Their poorly targeted and expensive benefit systems actually contributed to the deep fiscal crisis, which in turn severely constrained the scope for discretionary support when most needed. A significant reconfiguration of welfare systems to improve targeting would arguably protect disadvantaged groups more effectively and affordably (Matsaganis, 2011; OECD, 2013f).

The United States, where out-of-work transfers were relatively modest before the crisis, has done much more to strengthen income support in a counter-cyclical manner. The country’s transfer system directs a large share of working-age cash payments towards low-earning working families. To address the social risks of such a policy configuration when more and more people were finding themselves jobless for long periods, the United States combined a number of swift discretionary policy measures with “automatic” policy changes that extended unemployment insurance and safety-net benefits during the downturn, albeit from a comparatively low level (Immervoll and Richardson, 2013). Canada also combined discretionary and automatic policy adjustments. Although discretionary measures accounted for the majority of additional spending in both countries, the automatic benefit extensions described in Section 2 made support significantly more counter-cyclical, and it directed extra support to economically more fragile regions.[19] Importantly, such automatic provisions also strengthen the credibility of expenditure reductions in line with the recovery. These experiences are relevant to countries considering how to adapt social support systems more readily to variations in economic circumstances and household needs.

Striking the right balance between benefit recipients’ rights and responsibilities is one way to make transfers more responsive to labour-market conditions. Job-search requirements and activation measures help ensure that benefit expenditures decline when labour demand picks up. They also allow benefit administrations some room for manoeuvre to make benefits more accessible (e.g. by tailoring eligibility criteria to labour-market conditions) when job prospects are poor or when increasing numbers of jobseekers have no recent work experience. Moreover, activation policies contribute to better targeting by making support conditional on job-search efforts (Immervoll, 2012; OECD, 2013g). If well designed, such targeting can, in turn, create the fiscal space, and possibly the political support, that is needed to ensure support for individuals and families who require it.

Yet, a credible commitment to counter-cyclical redistribution rests on consistency between social spending and the revenues that finance them. In the United States, the pre-crisis boom years saw a budgetary and arguably a political marginalisation of first-tier transfers (unemployment insurance) and second-tier benefits [e.g. Temporary Assistance for Needy Families (TANF)] for workless individuals and households.[20] At a time when the recovery is still weak and poverty high, the pre-crisis erosion of revenue sources produced by pro-cyclical tax reductions (notably in the case of unemployment insurance funds) has now created strong pressures for across-the-board budget cuts and specific benefit cuts at state and federal levels.

Unemployment benefit, general social assistance, and active labour market programmes together account for an average of less than 10% of public social spending in the OECD. However, the downturn placed heavy additional demands on them. Even in the current economic context, margins for savings are still narrow and, ideally, reductions in benefit duration and recipient numbers should be paced to match recovery. Governments can improve both fiscal and social sustainability by committing to funding with a long view in order to balance finances across the economic cycle and maintain effective income support during extended downturns.

Structural policy reforms need to continue and be fiscally and socially sustainable

Key structural reforms of pensions and health care systems begun before the crisis should continue. Pensions and health care each account for 30% of total public spending in the OECD on average, and successful reforms in these areas create the fiscal space that enables governments to provide disadvantaged groups with adequate support, notably in the context of often rapid population ageing. Structural health care reforms should focus on identifying and reducing unnecessary supply of services and on savings through efficiency gains. Untargeted cuts, for example in the form of higher co-payments, should be avoided as they restrict access to health services for the most vulnerable.

As for pensions, short-term and temporary reforms – like freezing benefit levels – have an immediate impact on public finances. But they may also heighten the risk of poverty among the low-income elderly unless supplementary measures are taken in parallel. Structural reforms that seek to restore the long-term sustainability of pension systems – e.g. raising retirement ages and lengthening contribution periods – can achieve greater savings, albeit with a longer time lag. While short-term fiscal pressures may cast the spotlight on certain elements of public pension provision, it is important to consider retirement income more broadly. The economic crisis has already had a serious effect on households. And it will not end there. It will also affect the retirement situation of the current working-age population. Across all spending areas, an overarching challenge is to identify reforms that are effective in alleviating the impact of economic crises on both households and government budgets, not only now, but for later years as well.

Notes

1. While such recent data are not available for the entire OECD area, they cover countries with very different degrees of exposure to the crisis.
2. There is new evidence that the duration of unemployment determines chances of obtaining a job interview. This effect can be expected to be stronger when labour markets are relatively tight and is therefore of growing concern once labour markets recover (Kroft et al., 2013).
3. The negative effects of unemployment during someone’s initial years on the job market tend to be both strong and long-lasting, especially for disadvantaged youth (OECD, 2010a; Scarpetta and Sonnet, 2012).
4. General government includes central, state and local government as well as social security funds. The latest data are for 2012 and are available for 26 countries. *Source: OECD National Accounts*.
5. Immervoll and Richardson (2013) summarise a number of recent studies for Europe and the Unite States.
6. Relative income poverty is the share of people with income below half of the national median.
7. The figures show *relative* income changes for different income groups. Starting points are very different across countries, with the United States, the United Kingdom or Poland recording much higher levels of market-income inequality than Denmark or Finland.
8. Food insecurity is therefore a different concept from hunger or undernourishment, (FAO, 1996 and 2012; Radimer, 2002).
9. The OECD’s *How’s Life?* framework monitors a comprehensive set of well-being outcomes to assess trends in well-being at the individual level and differences in those trends across countries (OECD, 2013d).
10. Reporting of suicides differs across countries. In particular, trends in recorded suicides need not parallel numbers of *attempted* suicides, which could be of similar or greater interest from a “life dissatisfaction” perspective.
11. In Germany, the end of the transitional benefit, which had eased income losses for job seekers moving from insurance to assistance benefits, further reduced the NRR.
12. In Norway the termination of the “Waiting Benefit” in 2008 reduced the maximum duration from five years to two. In 2010, Denmark reduced the maximum duration of unemployment insurance benefits from four years to two.
13. In Canada, the number of insured hours of employment that jobseekers need in order to qualify for unemployment benefits also varies with provincial unemployment rates.
14. Activation policies are a combination of measures that provide support and incentives for: i) job search and job finding; ii) productive and rewarding participation in society; and iii) self-sufficiency and independence from public income support. See OECD (2013g).
15. Immervoll (2013) discusses options and priorities for reforming out-of-work benefits in the context of a weak labour market.
16. Since women are, on average, paid significantly less than their partners, households often suffer earnings losses overall even if women attempt to compensate their partner’s earnings loss by working significantly more. Persistent gender wage gaps reduce women’s ability to help stabilise family incomes. In addition, adverse labour market conditions and the fear of losing their job lead some to work longer hours without being paid accordingly.
17. In 2011, 12% of employees in the OECD area were on fixed-term contracts. The proportion was much higher among youth. One-quarter of employees aged between 15 and 24 years is on a fixed-term contract in the OECD area, but more than one-half of young people in France, Germany, Italy, the Netherlands, Poland, Portugal and Switzerland have temporary jobs and over 70% in Slovenia (OECD, 2013b).
18. Key results, especially among youth, include the findings of Bell and Blanchflower (2009), Mroz and Savage (2006), Oreopoulos et al. (2012), Gregg and Tominey (2005), Arulampalam (2001), Kletzer and Fairlie (1999), Ellwood (1982). Findings of substantial scarring of low-income and out-of-work spells are consistent with the historical income data shown in Figure 1.6 in Section 1 of this chapter, and the role that cyclical income changes play in shaping long-term trends of rising inequality: low-income groups fall significantly further behind the rest of the population during recessions, opening up gaps that subsequent upswings often fail to close.
19. The most important automatic provision, extended unemployment benefit durations, were first put in place in 1970. Since job losses during the recent “Great Recession” have exceeded numbers

seen in earlier recessions, the relevant provisions were triggered in most states (Vroman et al., 2003). In addition to unemployment insurance, a number of safety-net benefits also include provisions that make them more generous, or more easily accessible, once state-level unemployment rates exceed a pre-defined threshold (USDA, 2012). Both discretionary and automatic adjustments need to be designed carefully, in order to avoid such unintended consequences as hindering mobility between regions with high and low unemployment.

20. On TANF policies and the decline in beneficiary numbers, see Anderson et al. (2011); Trisi and Pavetti (2012). For discussions and assessments policy challenges related to Unemployment Insurance, see Vroman (2011, 2012); McKenna and Wentworth (2011); Evangelist (2013).

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ANNEX 1.A1

Approach used to construct country groupings in Figure 1.8

The indicators used for the groupings are as follows:

- Household income (change 2007 to 2010): Real average household disposable income. *Source: OECD Income Distribution Database*. See also Chapter 3 "Household income".
- Public social spending (change 2007/08 to 2012/13): Real public social spending. Data are missing for Japan and Turkey. *Source: OECD Social Expenditure database*. See also Chapter 5 "Social spending".
- Recent consolidation effort (2011/12 to 2014): Change in general government underlying balances as a percentage of GDP. Data are missing for Chile, Mexico, the Slovak Republic and Turkey. *Source: OECD Economic Outlook*, No. 93 (May 2013).
- Expected future consolidation effort (2014 to 2030): Average annual consolidation from 2014 onwards to achieve a notional target of gross government debt (60% of GDP) in 2030. Data are missing for Chile, Mexico, Norway and Turkey. *Source: OECD Economic Outlook*, No. 93 (May 2013).

Countries with a change above the country average plus 0.5 standard deviations were classified as "high" or "large", those with a change below the country average minus 0.5 standard deviations were classified as "low" or "small".

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