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Comments welcome

**Changing the paradigm in social security:  
From fiscal burden to investing in people**

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## 1. Introduction<sup>1</sup>

Since the mid-1980s, national social security systems in many countries have come under pressure from several directions. Social security or social protection systems<sup>2</sup> (also often called the “welfare state”) can be understood as being a set of institutions, measures, rights, obligations and transfers whose *primary goal* is:

- (a) to guarantee access to health and social services; and
- (b) to provide income security to help to cope with certain significant risks of life (*inter alia* loss of income due to invalidity, old age or unemployment) and prevent or alleviate poverty.

From a global legal perspective social security has been recognized as a right of people. Universally negotiated and accepted legal instruments that describe social security as a fundamental societal right, and that grant this right to every human being, are:

- Article 22 of the Universal Declaration of Human Rights, and
- Article 9 of the International Covenant on Economic Social and Cultural Rights.

Social security as a human right is an explicit part of the ILO’s mandate<sup>3</sup> and is enshrined in a series of ILO Conventions, most prominently Convention No. 102 Social Security (Minimum Standards) which became the blueprint for the European Code of Social Security and other regional instruments.

Many industrialized market economy countries explicitly accepted that right and developed extensive systems providing various social transfers as an inherent part of the post-war environment of high economic growth rates, but such systems have come under strain in the more recent conditions of reduced growth, which seem likely to continue for the foreseeable future. A *new economic paradigm* has become established, in which it is perceived that any increase in “equity” (broadly defined) must be traded off against economic efficiency.<sup>4</sup> In this view, social security has come to be seen by some observers as a “luxury” which may be unaffordable, particularly in economies undergoing restructuring. Consequently, the fiscal space available in national economies for social transfers was limited or reduced in many countries, and a significant proportion of expenditure formerly undertaken from the public exchequer was shifted to private systems or to private out-of-pocket outlays. At the same time, the many systems of transfers faced new demands triggered by changing family patterns, ageing populations and higher levels of unemployment. This combination of stresses on national social security systems was exacerbated by increasingly strident demands for reduced levels of taxation in response to both real and perceived competitive pressures as the process of globalization gathered pace from the second half of the 1990s. The new economic paradigm, in which it is suggested

<sup>1</sup> Some parts of this paper draw heavily on Cichon et al. (ILO): “Financing social protection”, Geneva, 2004.

<sup>2</sup> The term “social protection” is used in this paper inter-changeably with “social security”.

<sup>3</sup> See Declaration of Philadelphia (1944). Article III provides for a broad definition of social protection.

<sup>4</sup> Quote A. Okun.

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that social welfare must be “traded off” against economic growth in times of global competition, naturally influences the development of social security systems in developing countries where they are most needed. Globally, the result has been an increase in “social insecurity”.

The aim of this paper is to recapitulate the role of social security in economies and societies, to identify the approaching new challenges, and ultimately discern the policy responses which will be needed to allow the ILO to assist its member States to optimize their national systems of social security within an overall Decent Work context. In the course of the discussion, we reassess and strongly contest the alleged economic trade-off.

## **2. The role of social security for decent work and decent societies**

### ***Developmental pattern of social security coverage***

In the major established market economy countries the historical developmental patterns of social security coverage have mirrored developments in the labour markets. Coverage began to increase following the European Industrial Revolution, as formal, wage and salary employment in industry increased and the workforce migrated from rural areas into towns.

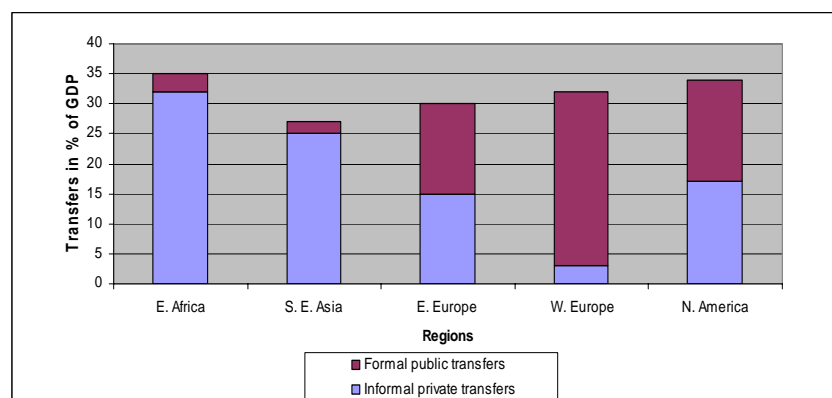
The coverage ratios by public social security systems in the developing world are low. This does not mean that people living there have no access to certain social security arrangements. Traditional modes of social protection, i.e. largely family and community support systems, still cover wide sections of developing country populations. The ILO report to the International Labour Conference 2001 compared the estimated overall level of transfers in the regions around the world with the levels of formal public social transfers (expressed as percentages of national GDPs) as recorded in official statistics. It was observed that the proportion of public transfers (implemented through public social protection systems) is strongly correlated with the level of countries’ economic development. It appears likely, therefore, that the changes in family and social structures, modernization and democratization of societies, that normally accompany economic developments, and lead to increasing reliance on public social transfers, will be reflected in increasing levels of social transfers, as a proportion of the overall national wealth. Such increases also reflect increasing population coverage and the increasing sophistication of benefit entitlement schemes.

One has also to remember that although informal, traditional social protection arrangements provide certain basic levels of income security, it often comes at a high costs to the recipients: it is usually far from being based on altruism and such support often entails humiliation, restriction of freedom, even slavery and obligations to reward the protection much beyond its actual worth. Contrary to modern social security arrangements, based on clear entitlements and rights, including rights of appeal, traditional arrangements are entirely discretionary, making recipients totally dependent on those providing support. A participatory poverty study carried out in Tanzania reveals the ways in which traditional family and community structures fail to provide effective social protection in situations of extreme poverty.

There is also another important function of public social security systems, which cannot be delivered by traditional forms of social protection based families, clans and local communities: redistribution of the fruits of economic growth on the national scale. Only national social security systems can deliver economic growth which is not only equitable, but also sustainable. A necessary condition for the continuation of economic growth and productivity is that such growth is expressed in the widest distribution amongst the layers

of society of health, wealth and better education. This is the lesson one can draw from development of many European countries in the post-war period.

**Figure 1.** Estimated total transfers<sup>5</sup> and their composition in selected regions, early 1990s (as a percentage of GDP)

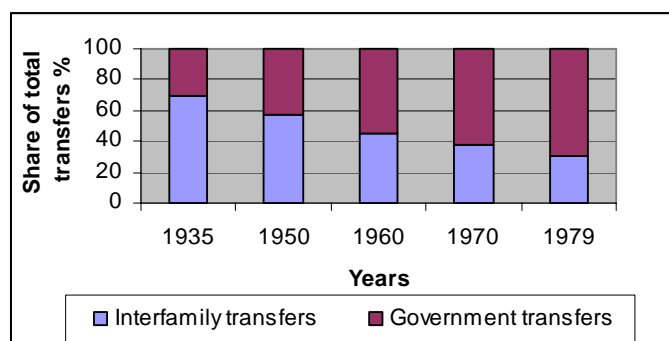


Source ILO (2001a), Chapter 5: "The Financing of Social Security".

It is a significant question as to whether the introduction of public transfers generally results in a fully offsetting reduction on private (interfamily and intrafamily) transfers, but it is one which has not been clearly answered to date. In the case of the United States, research by Lampman and Smeeding (1983, pp. 45-66) has established that the ratio of non-governmental, interfamily transfers to public transfers in the total transfers received by households was virtually reversed between the mid-1930s (when the social security system was introduced) and 1980 (see figure 2). However, the authors also observe that the absolute level of private interfamily transfers has remained almost constant. This means that while the public system has taken an increasing share of the responsibility for national social protection, it may also have increased the overall level of protection (or transfers) in absolute terms rather than simply replaced informal transfers.

<sup>5</sup> This estimate of the total social transfer ratio assumes that the economically active population (including the unemployed) earns all the income in a country (i.e. profits and wages) and is willing to share this income with children, inactive persons in the active-age group, and persons past the active age. It is assumed here that the relation of an economically inactive person's consumption to that of an active person is 0.666 to 1. This is, of course, a discretionary assumption. It assumes implicitly that a shift of dependents between old and young age groups will not necessarily change the overall degree of sharing. Added to cash transfers are crude estimates for the regional cost of health care, which are largely transfers in kind between groups as well as within groups. The transfer costs of unemployment benefits have been left out, since the available data does not allow the estimation of figures on a comparable basis between the developed and developing world. Formal transfers amounting to about 2 per cent of GNP could be added to the transfer ratios in Europe, North America and Oceania. In this case we would have to add informal transfers to the countries of the developing world, where the concept of unemployment is less clearly defined.

Figure 2. The shift from interfamily to government transfers in the United States, 1935-1980



Source: Lampman and Smeeding (1983).

For many decades it was assumed that the levels and patterns of public vs. private social transfers prevailing in the industrialized countries would – with a time lag of perhaps several decades – be achieved in the countries of the developing world. However, for the present, the vast majority of all social transfers in these societies are still implemented through private informal arrangements, and progress towards greater coverage through public systems remains slow. Between half and two-thirds of all workers work outside any formal contractual arrangements or registration of economic activity. Moreover, there remain many so-called formal sector workers who lack effective coverage by public social security systems.

Consequently, national social security or social protection systems need to reach out beyond the boundaries of the formal contractual employment. Many governments try to provide some form of access to health care or a minimum income guarantee offering support to individuals who cannot work or who can find work only in the low paying sub-sectors of the economies. Some countries have approached the problem through the provision of “universal benefits”, covering the entire population (such as for example the NHS in the UK or the universal pension schemes in some OECD countries and in some developing countries such as Namibia and Botswana), while others rely on specific measures, possibly administered by non-government institutions, for the so-called informal economy (such as micro-insurance schemes in Africa and Asia).

While some form of basic - often underfunded - health service is available at least in theory to between 50 and 80 per cent of people in most developing countries, coverage figures for formal cash benefits are even more disturbing. Estimates, admittedly based on fairly crude assumptions, nevertheless suggest strongly that no more than 20 to 30 per cent of the global population have access to meaningful cash benefits. Data emerging from the testing phase of the new ILO Social Security Inquiry as well as a recent ADB study of six Asian countries seem to confirm the order of magnitude of such estimates. There exist also significant gender imbalances in coverage ratios, as a result of the employment-related nature of many social security schemes and the relatively low employment for women; even in developed countries actual coverage rates for some of the major contingencies are much lower for women than for men. For example, an ILO study on the social protection system in Poland<sup>6</sup> revealed that while nearly all men at age 70 or more are receiving one or another type of pension coming from their own social security rights, the same is true

<sup>6</sup> Hagemeyer, K.; Liwinski, J.; Woycicka, I.: Social Protection Expenditure and Performance Review, Poland: Social protection in transition (Geneva, ILO, 2001), pp. 68-69.

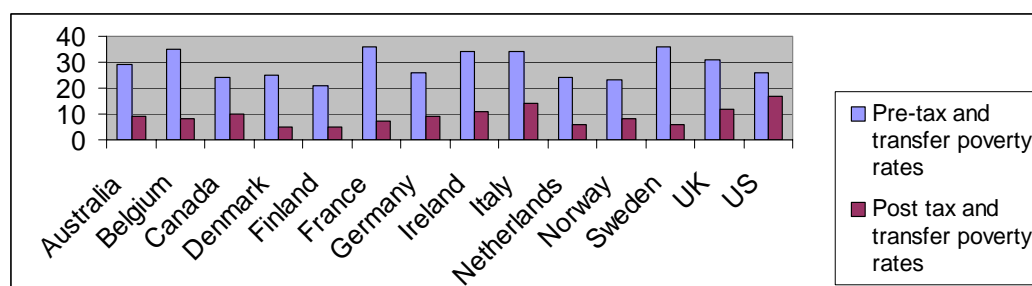
only for less than 70 per cent of women at the same age. More than 30 per cent of elderly women either never acquired rights to their own pension or the benefit appeared to be lower than survivors' pension of their deceased husband.

## Social impact

Social security systems providing social transfers are the key instruments offering a vehicle for the abolition and prevention of poverty, which is direct and fast in a way that the putative benefits of “trickle down” effects of economic growth cannot match. The International Financial and Actuarial Service of the ILO has conducted a study designed to estimate the level of resources which would need to be applied, at the global level, to address the problem of ongoing poverty in this way. A hypothetical package of minimum social provision was devised for this purpose, comprising basic education, access to basic health care and income transfers in case of need. The results indicated that a mere 2 per cent of global GDP would be needed to provide such a minimum package of benefits to all of the world's poor. Most of these resources could be raised nationally, although some transfers would be needed at the global level (between countries) to help the poorest countries with GDP per capita close to or below the global poverty line cope with their problems.

There is clear evidence from Europe and OECD countries that social transfers successfully reduce poverty and social insecurity.<sup>7</sup> Figure 3, below, shows the net estimated effect of public transfers and taxes on poverty rates (as measured by the poverty head count index, which is perhaps the clearest indicator of income inequality) in OECD countries, i.e. in countries with a fairly extensive social transfer system and well developed tax systems. The effects are nothing less than dramatic. The reduction of the pre-tax and transfer poverty rates ranges from a minimum of about 10 percentage-points, estimated in the US, to a high of around 30 percentage-points, found for Sweden.

Figure 3. Pre-tax and transfer vs. post-tax and transfer poverty rates in selected OECD countries in the middle of the 1990s (referring to total populations)



Source: OECD.

It is not possible to draw such clear-cut conclusions in relation to developing countries, since overall volumes of social transfers are comparatively small. However, some basic social protection transfers, such as basic non-contributory pension schemes have proven to be potent means in the fight against poverty. A variety of countries have introduced universal pension schemes in recent years, and while they have mostly provided benefits at modest levels, their effects by way of poverty reducing effects for whole families have been very positive. Benefits are provided overtly for the old and disabled, but in practice benefits provided for individuals – whose status in their families is often significantly

<sup>7</sup> Cichon et al. (ILO): Financing Social protection, Geneva 2004, pp. 37-41.

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enhanced through their receipt of a cash income – effectively support whole families. Redistribution of cash income within the household, means that more families than hitherto are able to finance school fees, medicines, etc.<sup>8</sup> Strong evidence of positive experience comes from countries as diverse as Brazil, Mauritius, Namibia, Nepal and South Africa. The ILO's International Financial and Actuarial Service has calculated that the provision of such a basic package of social transfers in most countries would cost between 1 and 2 per cent of GDP, which would equate roughly to between 5 and 10 per cent of national budgets. Implementing such a package in many countries could represent a rapid first step in a broader attack on the kind of deep-rooted and chronic poverty often found in "pockets" within countries.

Social transfers also have a marked impact on income equality, which can be interpreted as an indicator of social coherence. Evidence from the Luxembourg Income Study<sup>9</sup> of the mid-1990s (thus before the recent wave of reforms) shows that the combined tax and transfer systems in OECD countries reduce income inequality by between 40 per cent and 50 per cent in countries including Belgium, France, Germany and Sweden, and by between 20 per cent and 30 per cent in countries such as Australia, Canada, the United Kingdom and the United States. Prominent observers of the emerging inequality in Europe and OECD since the mid-1990s, including Smeeding (2002)<sup>10</sup> and Atkinson (2002)<sup>11</sup>, attribute increasing inequality within societies, as measured by increasing Gini coefficients, to changes in governments' tax and transfer policies. Atkinson (2002) concludes that, when analysing the impact of globalization and public policy on changing income equality, "... we must not lose sight of policy. Changes in tax and transfer policy have played a major role in the increasing inequality in a number of countries. To a considerable extent the developments of inequality in disposable incomes – what matters to our citizens – lies in our own hands."

One may ask why, then, is the reduction or containment of social expenditure a predominant pre-occupation of policy makers in many countries around the world? Why then do the majority of people in the world lack access to even basic social security? Why are many of those who provide advice to poor countries reluctant to support major transfer programmes? Why is there not enough support within the countries themselves? We may suggest that the answer lies in the "new economic paradigm" (see above), the growing influence of which may be traced back to the late 1970s or early 1980s. That social security systems are indispensable to the translation of economic growth into sustainable development and the alleviation of poverty is an essential prerequisite to the policy case for their promotion. As long as the belief prevails that social security leads to lower growth and welfare losses, that case is undermined, and we therefore devote the next section to a critical appraisal of this alleged "trade-off".

<sup>8</sup> Age and Security: How social pensions can deliver effective aid to poor older people and their families. HelpAge International, London, 2004.

<sup>9</sup> See Ruiz-Rueta, J. et al: Earnings inequality, unemployment and income distribution in the OECD, LIS working paper No. 214. , New York, 1999.

<sup>10</sup> Smeeding, T.M.: Globalization, Inequality and the Rich countries of the G-20: Evidence from the Luxembourg Income Study (LIS), Sydney, May, 2002.

<sup>11</sup> Atkinson, A.B.: Income inequality and the welfare state in a Global Era. New York, 2002.



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### 3. The growth vs. equity trade-off: a critique

National social protection systems and their perceived effects on economic performance have been subject to intense policy debates in many countries over recent decades. On the one hand experts<sup>12</sup> claim that social systems redistributing up to 35 per cent of countries' GDPs are no longer affordable. Social protection expenditure at and beyond this level is seen as an impediment to growth, with negative effects in both the short- and the long-term. Others hold an opposite view and consider social protection – if well managed – to be a genuine productive factor.<sup>13</sup> A team of ILO writers concluded recently:<sup>14</sup> “*Once all the arguments are on the table, the outcome of the theoretical debate on the potential positive versus negative economic effects of the welfare state appears to be a draw...*”.

For the policy analyst and the decision-maker, an inconclusive debate is of limited help. However, what is needed for policy formulation is not the proof that social transfers have a direct positive impact on growth, but rather that substantial levels of social expenditure and economic growth can co-exist. Furthermore, such transfers are the tool to make the economic growth equitable, thus strengthening its sustainability.

The substantial global economic growth rates in many countries over the last years have not translated into an equally fast decline of poverty or social insecurity. At the same time social insecurity has been increasing in many countries as social protection levels are reduced. Since about the mid-1970s, i.e. after the first oil price crisis, countries with well-established social security systems entered a period of *welfare state containment*. Nevertheless, major welfare states such as Austria, Germany, France, the Netherlands and others, broadly maintained their social expenditure, as measured by the percentage allocation of GDP, at the levels reached in the mid-1970s.

In fact, all social expenditure containment measures reflect the *new paradigm of economic policy*, increasingly dominating political and socio-economic discussions and analyses over the last 20 to 25 years, in which it is claimed low European growth rates have come about mainly as a result of social protection provisions which are too high in magnitude and wrongly designed (mal-structured). It is not clear yet whether this “new paradigm” will result in even further reductions in social spending. All that can be observed at present is that social expenditure in the OECD (measured in per cent of GDP) has stabilized at long-run levels, and that this applies equally to low and to high growth countries. It is evident that policies of this kind have not led to higher economic growth. Economic growth rates have generally declined to moderate levels since the mid-1970s. With regard to social protection, governments of major countries have, over the past 30 years, taken measures repeatedly to maintain social protection spending at country specific *constant* levels,<sup>15</sup> while, over the same time, GDP growth rates have followed a general secular trend of decline.

Nevertheless, countries continue to implement policies designed to contain public social expenditure. The reasons quoted for so doing usually concern the affordability of social security systems. It is argued that poor countries simply cannot afford any major transfer

<sup>12</sup> IMF (2003), Ch. IV.

<sup>13</sup> Conclusions concerning social security, International Labour Conference, 89<sup>th</sup> Session, 2001.

<sup>14</sup> Cichon, Scholz et al. (2004): Financing social protection, p. 121.

<sup>15</sup> There are, of course, exceptions to this observation. Greece, for example, extended its social spending substantially over a period of about 20 years while Ireland significantly reduced its spending share in GDP over the recent past.

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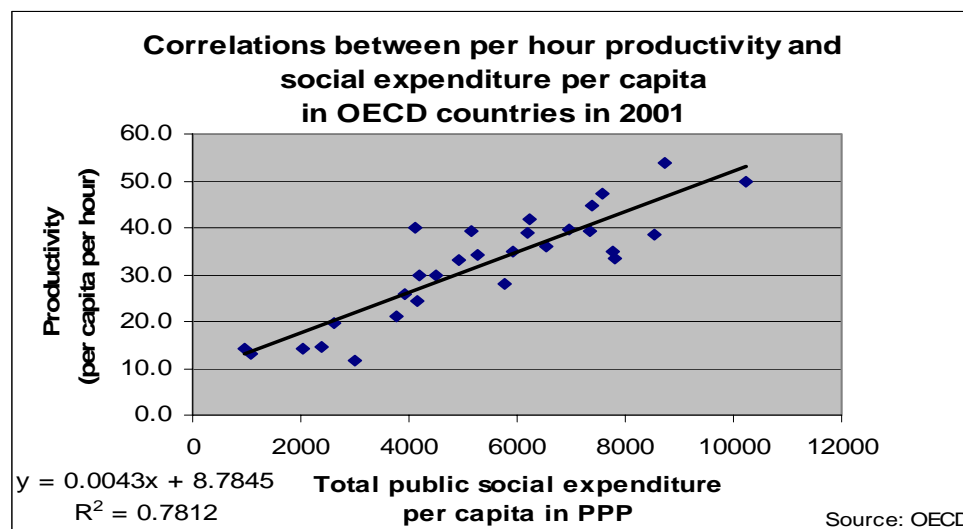
programme. This is based, in turn, on the need to keep their taxes and public spending at low levels, so as, on the one hand to be competitive in the global economy (low social security contributions and low other taxes will help to bring in foreign investments and will allow exports to remain cheap) and on the other hand to keep work incentives high. In the advanced countries the same arguments are put forward. Additional fears are triggered by the expected consequences of ageing societies on the level of taxes and contributions. Some believe that too much security, particularly income security, undermines people's incentives to engage more in economic activities, be inventive and productive. But the truth is likely to be exactly the opposite: the less secure we feel, the more averse we will be to take the risk. Studies reveal that poor people are risk averse. Rational risk-averse individuals will take a risk only if a potential loss is relatively small compared to his or her wealth. If the marginal utility of money is diminishing, rich people can thus risk much bigger absolute amounts of resource while the poor will not be eager to risk even small amounts as this undermines the probability of their very survival. Wealth provides security, and more can be risked. Social security substitutes wealth for many people. Rational individuals will also take additional economic risk if he/she is relatively well protected against other risks he/she has to cope with, like sickness or disability. Those who have no access to relevant protection mechanisms against numerous social risks will tend to avoid taking any additional economic risks, as they have to focus on protecting themselves against the first. The poor have practically no access to hedging instruments, which the richer people can use to hedge economic risk, which they are taking.

But how much social security is affordable? OECD countries spend between 10 and 30 per cent of GDP on social security - usually between one-third and half of total public expenditure. Countries at the same level of economic development differ significantly in how much they spend on social security. The size of the social security system is obviously shaped mainly by prevailing political attitudes towards redistribution rather than stringent "economic laws". Affordability is a function of the societal willingness to finance social transfers through taxes and contributions. Social security systems, which perform in a way approved by the majority of the general public, are usually also affordable – whatever their size. Systems, which perform badly from the point of view of the general public usually lose support and acceptance and may become unaffordable even if relatively small in fiscal terms.

A recent statistical analysis<sup>16</sup> by the ILO's Social Security Department corroborates that investing in equity and security through social transfers is clearly not incompatible with economic performance and that the equity/equality vs. growth trade-off is most likely an outdated belief. Figure 40 shows that in the OECD region there is a strong positive correlation between social expenditure (per capita of the population) and labour productivity (GDP per hour worked).

<sup>16</sup> Quote GB paper.

Figure 4. Labour productivity and social expenditure



Source: OECD, SOCX database.

The correlation between “simple” per-capita (per worker) productivity and social expenditure (per capita of the population) is also positive but less tight. While the nature of the actual causality behind this correlation may not be fully researched yet, one conclusion is obvious: an extensive social security system is not incompatible with a highly productive economy. The famous trade-off does not hold.

#### 4. The main challenges to social security systems

The demographic, economic and societal environments within which national social security systems are operating are obviously rapidly changing. These changes pose obvious challenges for societies and their social transfer systems. Consequently, there are new macro trends in the structure of national social security systems that can be discerned during the last decade that can at best be described as centrifugal and yet their causes are to some extent interconnected.

##### *The global demographic transition*

The key indicators for the demographic stress on national social transfer systems are the dependency rates. The demographic environment of a social protection system, which includes the morbidity structure of the population with which the health system has to cope, co-determines the *system dependency ratio* – that is to say, it influences the ratio of the number of beneficiaries (i.e. transfer recipients) in the system to the number of people financing these transfers or earning the national income out of which the transfers have to be financed. Demography is not the exclusive determining factor, as governance too has a marked impact on dependency. Biological factors (ageing as expressed in dropping fertility and mortality rates, morbidity and mortality) determine to a large extent the potential number of beneficiaries and financiers of the national social protection system; in other words, they explain the *pure demographic dependency ratio*. Demographic factors do not explain the full size of system dependency: the economy co-determines the number of unemployed while national law, which is a governance factor, co-determines the number of people who are retired and of those receiving education. This last number is influenced for example through legal provisions governing the minimum number of years of compulsory schooling or of studies required for the first university degree.

The other determinants – economic development and governance factors – being equal, ageing is the most important factor of influence on pension schemes, which are, in turn, the biggest expenditure items in national social protection systems. That impact is especially strong in mature systems in societies with a high proportion of elderly covered by social security. However, table 1 reveals another fact that may come as a surprise: while developed regions are substantially “older” than less developed ones, the pace of ageing is actually much faster in the developing world. So, if the less developed countries had pension systems with universal coverage (which they do not, with a few exceptions like Botswana, Brazil, Namibia and South Africa), in relative terms they would face an even more serious ageing problem between 2000 and 2050 than the schemes in more developed parts of the world.

**Table 1. Rate of demographic ageing, population aged over 60 and over 80 (as a percentage of total population) (United Nations projections – medium variant)**

		1950	1960	1970	1980	1990	2000	2010	2020	2030	2040	2050
World	60+	8.2	8.2	8.4	8.6	9.2	10.0	11.1	13.5	16.5	18.8	21.1
Males	60+	7.3	7.3	7.4	7.5	8.1	8.9	10.0	12.3	15.1	17.2	19.4
Females	60+	9.0	9.0	9.5	9.7	10.4	11.1	12.3	14.8	17.9	20.4	22.7
	80+	0.5	0.6	0.7	0.8	1.0	1.1	1.5	1.8	2.3	3.1	4.1
More developed regions	60+	11.7	2.6	14.5	15.5	17.7	19.4	21.9	26.1	29.8	32.0	33.5
	80+	1.0	1.3	1.6	2.0	2.7	3.1	4.2	5.0	6.4	8.3	9.6
Less developed regions	60+	6.4	6.2	6.1	6.4	6.9	7.7	8.8	11.1	14.2	16.7	19.3
	80+	0.3	0.3	0.4	0.4	0.5	0.7	0.9	1.2	1.5	2.3	3.3
Less developed regions without China	60+	5.9	5.7	5.8	5.9	6.2	6.8	7.7	9.5	11.8	14.2	16.9
	80+	0.3	0.3	0.4	0.4	0.5	0.6	0.8	1.0	1.3	1.8	2.5

Source: United Nations, *World Population Prospects, The 2000 Revision, Volume II: The sex and age distribution of the world population*, United Nations, New York, 2001.

Figure 5 on the other hand, reveals that - while pension schemes may face increased dependency - for overall social security systems, the challenge appears to be much smaller. The figure takes the analysis of transfer dependency one step further. It includes persons not economically active into the overall dependency calculation. The figure shows that the combined number of children, those of working age who are inactive and elderly per 100 economically active people is declining. This is largely due to a rapidly declining number of children in the developing world. The picture may again be to some extent misleading as – for the time being – a number of those economically active belong themselves to the working poor. Thus the actual global transfer dependency may be higher than indicated by the figure.

Figure 5. Global economic dependency ratios

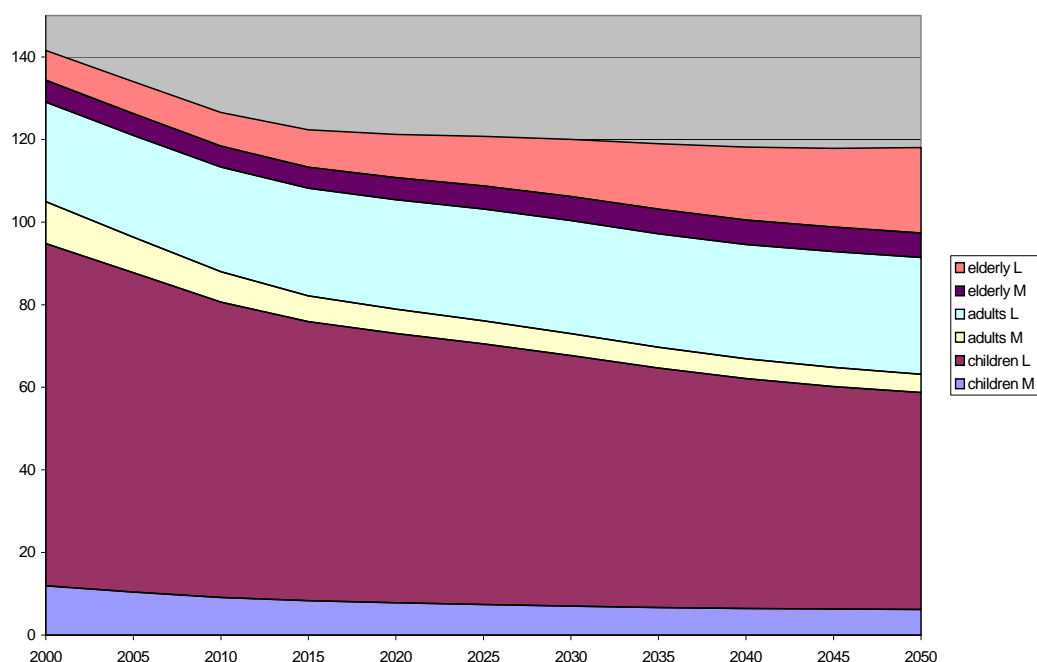
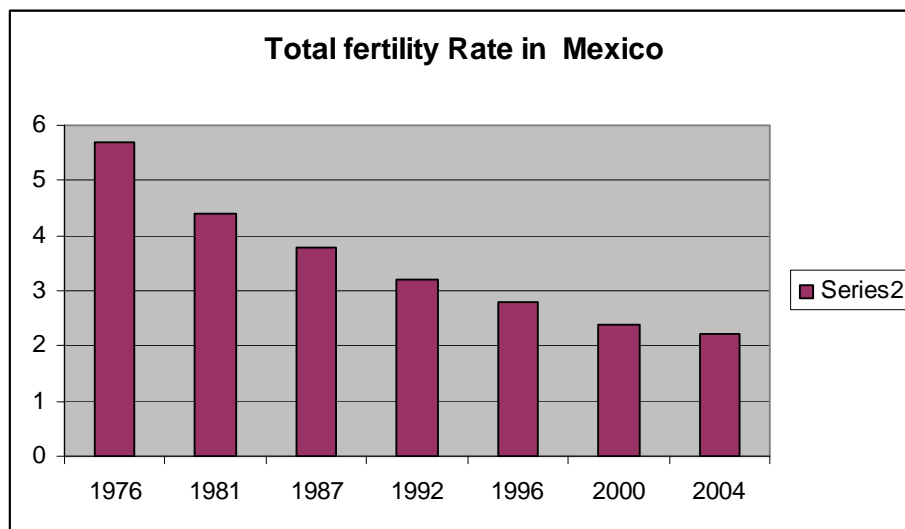


Figure 6 also demonstrates the effects of one of the most dramatic aspects of the demographic transition: rapidly dropping fertility rates. As already mentioned, global average fertility rates dropped within the three decades from 1970/75 to 2000/05 from 4.49 to 2.65, i.e. by about 40 per cent. This is by no means a phenomenon that only applies to developed countries. The following figure represents the developmental pattern for Mexico over the last three decades exemplifying the extent of the demographic transition in the developing world.

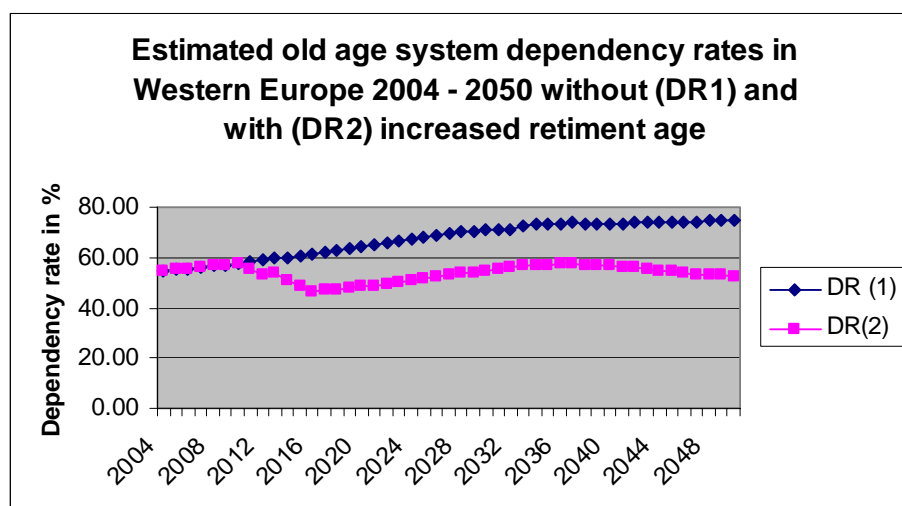
Figure 6.



Sources: S. Guterman, PWC (November 2005).

Perhaps surprisingly, there is still reason to believe that the global demographic transition poses a manageable challenge. Should European and OECD countries be able to manage their own demographic transition, they might even be in position to free some fiscal space for the alleviation of demographically triggered poverty problems or health problems in other parts so the world (*inter alia* in regions with high prevalence of HIV/AIDS). The key indicator for Europe alleged “demographic catastrophe” in social security has always been the old-age dependency rate. However, that problem might not be as big as it seems. The reason seems quite simple. The following figure 7 shows that on the basis of the demography of rapidly ageing Western Europe,<sup>17</sup> the increase of retirement age or better the extension of the *de facto* working life is probably a solution for most pension schemes. By means of calculations using a relatively simple model<sup>18</sup> it can be shown that the problem of increasing demographic burdens can be contained by measures that increase labour force participation. An increase of the labour force participation rate of the age group 15 to 64 years through various measures such as the increase in labour force participation rates of women to levels slightly below that of men, and increased overall rates due to earlier entries into the labour force, but first and foremost a gradual increase of the *de facto* retirement age from 60 today to 65 (here simulated between 2011 and 2021), the old-age demographic dependency rate can be kept at the present level for the next five decades.

Figure 7.



Source: ILO-FACTS estimates.

Not all of the potential increase of labour force participation and the increase of the retirement age might be achievable in practice. The difference has to be made up by migration if the overall level of standard-of-living is to be maintained in ageing societies. In any case, the ageing problem of societies cannot be reduced to a pension problem. Overall and per capita GDP growth rates are at risk when populations age and employable

<sup>17</sup> Combined data for Austria, Belgium, France, Germany, Liechtenstein, Luxembourg, Monaco, Netherlands and Switzerland taken from the UN 2002 population projections.

<sup>18</sup> The model assumes a long-term average increase of 2.5% of real GDP per annum, long-term average increase of labour productivity per worker of 2%, a starting unemployment rate of 10% in 2004, a starting labour force participation rate of 80% for males and 70% for females with increases to 90% and 85% respectively.

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labour forces shrink. The latest EU publication, for example, submitted to the EU Summit in October 2005 conceded that ageing under status quo conditions may act as a brake to economic growth bringing it down on average from 2.0–2.5 per cent per annum to half that rate.<sup>19</sup> The achieving of increased labour force participation rates for all ages over 18 to 20 is imperative for the maintenance of standards-of-living in ageing societies. Migration can help to maintain a stable dependency rate but will only provide partial relief or lead to exploding populations. The maintenance of a sufficiently big endogenous labour force remains crucial.<sup>20</sup> Creating suitable jobs for older workers remains the real challenge for ageing societies and remains one of the key policy tools for disarming the “ageing crisis”.

Other tools might come to light if a closer analysis of family-friendly policies with respect to access to social services, child care and social transfers for families, were to be undertaken. Fertility rates in Denmark and France, for example, remain relatively close to replacement levels, while their neighbours (e.g. Germany and Italy), experience much lower rates. A recent OECD study (Sleeboos 2003),<sup>21</sup> however, only finds a weak positive impact of family policies on reproductive behaviour.

However, even if – in the worst of all scenarios - the management of the demographic challenge were to fail generally, the effects on the sustainability of national social transfer systems even in countries with highly developed systems might be less dramatic than commonly assumed. The Economic Policy Committee of the European Union produces projections of the combined cost of the most important social security benefits as a result of ageing populations. The following table displays the latest available forecast.

<sup>19</sup> cf. EU: Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee on the regions: European values in the globalized world, Brussels, Oct. 2005, p. 11.

<sup>20</sup> See Cichon; Léger; Knop (2003).

<sup>21</sup> OECD (Joelle Sleeboos): Low fertility rates in OECD countries: Facts and policy responses - OECD Social, Employment and Migration, Working Paper No.15, Paris, 2003, p. 48.

Table 2. Projections for public spending on pensions, health, long-term care, education and unemployment benefits – EU 15 – 2004-2050

	2004	2005	2010	2015	2020	2025	2030	2035	2040	2045	2050	Change 2004-
BE	25.4	25.3	25.1	25.5	26.6	28.2	29.9	31.1	31.6	31.8	31.7	6.3
DK	26.8	26.8	27.0	27.9	28.6	29.5	30.8	31.7	32.1	31.9	31.6	4.8
DE	23.7	23.4	22.5	22.2	22.9	23.8	24.7	25.4	25.7	26.1	26.4	2.7
GR	*	8.9	8.9	8.7	8.7	8.9	9.1	9.4	9.7	9.9	10.2	1.2
ES	20.1	20.0	19.7	19.6	20.4	21.7	23.4	25.2	27.3	28.7	28.6	8.5
FR	26.7	26.6	26.7	26.9	27.6	28.1	28.6	29.4	29.6	29.7	29.6	2.9
IE	15.5	15.2	15.4	16.3	17.1	18.0	18.8	19.7	20.7	22.1	23.3	7.8
IT	26.2	26.2	25.7	25.6	25.9	26.4	27.3	28.1	28.7	28.6	28.0	1.7
LU	19.5	19.5	19.4	20.5	21.6	23.5	25.0	26.6	27.4	28.1	27.8	8.2
NL	20.9	20.5	20.6	21.5	22.4	23.4	24.7	25.7	26.2	26.1	25.8	5.0
AT	25.2	24.9	24.2	24.0	24.2	25.2	26.0	26.5	26.1	25.7	25.3	0.2
PT	23.8	24.2	24.2	24.9	26.3	27.1	28.0	29.5	31.1	32.6	33.6	9.7
FI	25.4	25.2	25.6	26.5	27.7	28.8	30.1	30.8	30.7	30.6	30.6	5.2
SE	29.6	29.2	28.2	28.3	28.6	29.5	30.9	31.7	31.9	31.7	31.8	2.2
UK	19.6	19.6	19.4	19.5	19.9	20.7	21.8	22.5	22.9	23.2	23.6	4.0
CY	16.4	16.4	16.5	16.7	17.6	18.8	20.5	21.9	23.4	25.0	28.2	11.8
CZ	19.3	19.3	18.8	18.6	19.2	20.0	21.0	22.4	24.1	25.5	26.4	7.2
EE	17.1	17.5	16.5	15.4	15.1	15.0	14.8	14.6	14.3	14.3	14.4	-2.7
HU	20.7	20.9	21.0	21.3	22.3	22.9	23.5	24.7	26.4	27.4	27.7	7.0
LT	16.0	16.0	15.3	14.8	15.1	15.7	16.3	16.6	16.8	17.0	17.4	1.4
LV	17.5	16.9	14.6	14.1	14.6	15.5	16.0	16.2	16.2	16.1	16.2	-1.3
MT	18.2	18.2	19.1	19.7	20.4	20.5	20.0	19.5	19.2	18.9	18.5	0.3
PL	23.7	23.4	20.2	18.1	17.9	17.7	17.6	17.5	17.3	17.1	17.0	-6.7
SK	16.2	16.5	15.4	14.9	15.3	15.8	16.5	17.1	17.7	18.3	19.1	2.9
SI	24.2	24.2	24.0	24.5	25.5	27.0	28.6	30.2	31.7	33.0	33.8	9.7
EU25	23.4	23.3	22.7	22.7	23.2	24.0	24.9	25.8	26.4	26.7	26.8	3.4
EU15	23.5	23.3	22.9	23.0	23.5	24.4	25.4	26.3	26.8	27.1	27.2	3.7

Source: The impact of ageing on public expenditure: projections for the EU 25 member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050). Report prepared by the Economic Policy Committee and the European Commission (DG ECFIN), European Economy, Special Report No 1/2006-Annex, Table 1-1: Total age-related public spending: pension, health care, long-term care, education and unemployment transfers (percentage of GDP) – baseline scenario.

There are obvious problem cases but on average cost increase by less than 4 percentage-points of GDP over a period of 45 years appears to be a rather benign scenario.

## Changes in health, society and the labour market

### Public health issues

Another factor that rapidly changes the demographic environment, in which some national social protection systems operate, in particular in developing countries, are new public health threats. In addition to expected pandemics of other infectious diseases, the HIV/AIDS pandemic is the most prominent problem. The expected extent of the pandemic has been accounted for in the above global dependency figures, but none the less will pose substantial problems in some regions. In some regions of Africa, the infection rate is estimated to have reached almost 40 per cent. This very likely means that within the next five to ten years at the latest, out of every 100 people alive today 40 will have died, unless there is spectacular medical progress and – maybe even more importantly for Africa – if the cost of drug treatments does not go down. A crisis of this magnitude must have a dramatic effect on the cost of any national social protection scheme. It is probably fair to



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say that HIV/AIDS will most likely wipe out all the financial and fiscal room for the improvement of social protection that growth in Africa could have produced under normal conditions. It should not be overlooked, however, that – while less prominent and since contained to the poorest regions of the world – malaria has an even more dramatic effect on population structures and morbidity structures with which developing country health systems have to cope.

### ***Employment effects of globalization***

Domestic and export markets in almost all countries that participate in the global economy are experiencing ever tougher global competition. One reason is that since the early 1990s the former Soviet Republics, the countries of Central and Eastern Europe, as well as large parts of China and India, have joined the global labour market with relatively low labour costs – effectively doubling its size. High technology communication and fast and cheap means of transport facilitate global production chains but also the movements of goods, services and people.<sup>22</sup> The result is that technologies, and with it workplaces and skills become obsolete at an ever increasing pace. While the direct measurable effect of workplace migration, is obviously smaller than one would assume (the unemployment rate in all of OECD increased from 6.1 per cent in 1990 to about 6.9 per cent in 2004) and only an estimated number of about 0,5 million jobs in developing countries are identifiably jobs that produce goods and services for consumption in the developed world. The indirect and perceived effects on job security seem, moreover, to be even higher. However, in the longer run, the global competition will be much less about lower absolute labour cost, but about productivity and about social infrastructure facilitating economic activity and boosting productivity. There are many proofs that social security systems are indispensable elements of such infrastructure.

### ***Migration and family composition***

The ILO estimates that at the beginning of the new century about 175 million people world wide live outside their country of birth or citizenship;<sup>23</sup> among them about 90 million are migrant workers. At the same time, people are internally migrating from rural areas to urban areas. Globally the share of rural employment at total employment fell by 3 percentage-points, or about 90 million workers, to about 43 per cent between 1994 and 2004. Together with migrating dependents, the total number of persons that shifted from rural to urban already might be in the order of 200 million persons within a decade. There are obvious signs that these figures will increase dramatically due to rural-urban migration in China. Internal and external migration is triggered by a variety of reasons ranging from national or international conflicts, natural disasters to unemployment and poverty.

In many cases, however, only one family member migrates, seeking security or income in better paid jobs in urban areas or in other countries. This compounds the disruptive effects of HIV/AIDS and other diseases on family coherence and structures. In many cases migrants remain excluded from mainstream societies with all the associated risks for their own health and well-being as well as the risk that poses for the receiving societies. Integrating migrants into national social security systems is one way of integrating them into their new countries or the cities they chose to live in. On the other hand remittances of migrant workers account for a major share of the total volume of informal social transfer schemes in many countries. In the Philippines alone remittances are estimated to amount to

<sup>22</sup> See Changing patterns in the World of Work – Director-General's Report to the 2006 International Labour Conference – Draft, Mar. 2006, pp. 22–25.

<sup>23</sup> *ibid.*

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billions of dollars. These financial flows might help to finance more social security in the “exporting” countries and “regions”.

### ***Informalization of labour markets and economies***

The Report of the Director-General of the ILO to the ILC 2006<sup>24</sup> states that the expectations nurtured by the “dual economy” model that assumed that – drawing on the experience of industrialized countries – that most agricultural workers would move from rural into urban areas into manufacturing jobs. Hence there would be a gradual movement towards formalization of the largely informal agricultural labour force. That pattern of development does not hold true any longer. Manufacturing has ceased to be a major sector of employment growth in many regions and the rural and urban movement of labour is largely absorbed by trade, in particular, informal petty trade. The ILO presently estimates that the share of informal employment at total urban employment is 48 per cent in North Africa, 72 per cent in Sub-Saharan Africa, 51 per cent in Latin America and 65 per cent in Asia.

### ***Globalization and the new uncertainty***

The increased economic integration during the last decades of the twentieth century coincided with rising income inequality in some countries – and increasing unemployment among the low-skilled, mainly on the European continent. What matters here, however, in addition to the impact of internationalization on wages and employment (which reduces the national tax base) is the extent to which it affects the capacity of national governments to set their own targets with respect to social protection. Critics of the welfare state have argued that increased international openness creates difficulties in raising sufficient revenues, and therefore requires a downsizing of the welfare state. There is some evidence that countries are currently engaged in tax competition – although the effects seem to be much smaller than might be expected. In the case of tax competition triggered by globalization, we would expect to observe declining capital tax rates and rising labour and consumption tax rates. However, in a number of OECD countries average tax rates on labour increased, but the substantial decline in the tax base has been responsible for the rise in tax rates on labour income. The average effective tax rates were raised in order to compensate for the shrinking tax base.

According to the economic paradigm of the 1980s and the 1990s, expenditure reductions, even in the face of new social security needs triggered by the need for adjustments in the face of globalization seemed to be the logical way to reduce fiscal pressure on national tax bases. Consequently, while only gradually extending in developing countries the level of social security in industrialized market economies is declining. The cost-containment policies of the last decades are taking their toll. Health care systems are excluding services and increasing out-of-pocket outlays, benefit levels in unemployment and other cash benefit systems are declining.

Paradigmatic pension reforms changed established systems from defined-benefit schemes to at least partially defined contribution or notional-defined contribution schemes. Parametric reforms changed benefit formulae, reduced pension adjustments and increased retirement ages. Both types of reforms directly or indirectly seek to “off-load” some of the fiscal burden for financing income security in old age, disability and in case of the loss of the breadwinner, from public or quasi-public budget to private pockets.

<sup>24</sup> See ILO. *Ibid.* p. 24.

There was a strong belief in some quarters that the reforms converting widespread defined-benefit pension schemes, financed on pay-as-you-go basis into pre-funded defined contribution schemes will help to ensure the availability and affordability of pension schemes. On the one hand, there was a hope that such reforms would prevent contribution rates and other costs of the pension systems to grow as a result of ageing populations: unless people contribute longer and retire later, benefits will go down keeping the overall costs of pensions more or less constant. On the other hand, there was also a strong belief that such reformed systems, closely linking amounts contributed with future benefits and relegating re-distributive components to social assistance schemes will provide very strong incentives to contribute, even on a voluntary basis. Such systems were thus seen as a major instrument to increase the coverage of all those uncovered, particularly self-employed. Privatization of the management of the funds was supposed to strengthen these incentives: through providing higher rates of return and also through gaining higher public confidence than allegedly bankrupt public schemes.

The Chilean pension reform introduced already at the beginning of the eighties was the first attempt to implement policies following this new paradigm. The World Bank's publication "Averting the Old Age Crisis" in 1994, announced this new pension policy paradigm as relevant globally. Numerous studies of the reformed pension systems, particularly of those in Latin America<sup>25</sup> and in transition countries of Central and Eastern Europe<sup>26</sup> undertaken by the ILO over last several years confirm that outcomes of the reformed pension schemes may reduce income security in the old age of those covered; may reduce actual effective coverage of the population covered previously; and are not meeting expectations with respect to the increased coverage of those not covered before;

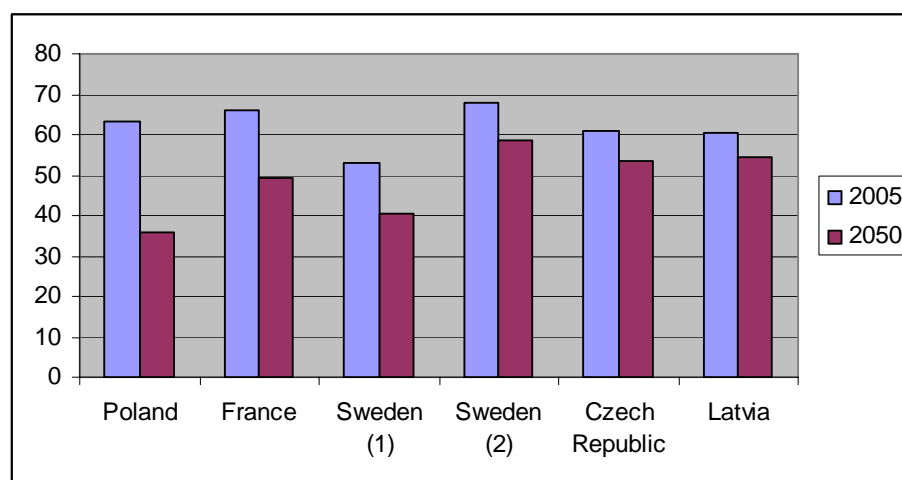
<sup>25</sup> Prospectiva de la previsión social Valuación financiera actuarial del Sistema Integrado de Jubilaciones y Pensiones 2005/2050, Serie de publicaciones de la Secretaría de Seguridad Social, añoF, Ministerio de Trabajo, Empleo y Seguridad Social y Servicio de Actividades Financieras, Actuariales y Estadísticas de la OIT, Buenos Aires, 2005; Argentina: Valuación actuarial del Sistema Integrado de Jubilaciones y Pensiones sal 31 de diciembre de 2001, Organización Internacional del Trabajo, Ginebra, Servicio de Actividades Financieras, Actuariales y Estadísticas, Programa InFocus sobre Respuesta a la Crisis y Reconstrucción, Oficina de la OIT en Argentina, 2004; Bertranou, ed.: Cobertura previsional en Argentina, Brasil y Chile, OIT, Santiago, 2001; F. M. Bertranou, C. Solorio, W. van Ginneken, eds: Pensiones no contributivas y asistenciales Argentina, Brasil y Chile, Costa Rica y Uruguay; OIT, Santiago, 2002; Alberto Arenas de Mesa, Paula Benavides Salazar: Protección social en Chile - Financiamiento, cobertura y desempeño 1990-2000, OIT, Santiago and Geneva, 2003, F. M. Bertranou, A. Arenas de Mesa, eds: Protección social, pensiones y género en Argentina, Brasil y Chile; El sistema de pensiones en Chile en el contexto mundial y de América Latina: Evaluación y desafíos, Ponencias del Seminario Internacional Oficina Internacional del Trabajo, Ministerio del Trabajo y Seguridad, Social Fundación Chile 21, Santiago, 2004; M. Nitsch, H. Schwarzer: Recent development in financing social security in Latin America, Issues in Social Protection, Discussion Paper 1, ILO, Geneva, 1996.

<sup>26</sup> E. Fultz, Pension Reform in the EU Accession Countries: Challenges, Achievements and Pitfalls, International Social Security Review, Vol. 57: Issue 2, Ap. 2004, pp. 3-24; The Gender Dimension of Social Security Reform in Central and Eastern Europe: Case Studies of the Czech Republic, Hungary and Poland, collection of papers by various authors edited by E. Fultz, M. Ruck, S. Steinhilber, ILO Budapest, 2003; Pension Reform in Central and Eastern Europe, vol. 1 (Restructuring with Privatization – case studies of Poland and Hungary) and vol. 2 (Restructuring of Public Pension Schemes – case studies of Czech Republic and Slovenia), collection of papers by various authors edited by E. Fultz, ILO Budapest, 2002; E. Fultz and M. Ruck, Pension Reform in Central and Eastern Europe: An Update on the Restructuring of National Pension Schemes in Selected Countries, ILO, Budapest, 2000; K. Hagemeyer, The Transformation of Social Security in Central and Eastern Europe, in: K. Müller, A. Ryll, H.-J. Wagener: Transformation of Social Security: Pensions in Central-Eastern Europe, Physica-Verlag, Heidelberg-New York, 1999; M. Cichon, K. Hagemeyer and M. Ruck, Social Protection and Pension Systems in Central and Eastern Europe, ILO, Budapest, 1998.

and the expectations with respect to increases of national savings rates. While some of the paradigmatic reforms have clearly improved the fiscal sustainability of some pension schemes, some of the basic ILO concerns have in the meantime been echoed by the World Bank's own Independent Evaluation Group (IEG). The Group's report on the evaluation of the World Bank's assistance to pension reforms<sup>27</sup> concluded *inter alia*: "There is little evidence that privately funded pillars have succeeded in increasing national savings or in developing capital markets ..." and "... the Bank's preoccupation with fiscal sustainability tended to obscure the broader goal of pension policy, that is, to reduce poverty and improve retirement income adequacy within a fiscal constraint"

Some countries in Europe introduced or consider introducing reforms similar to those in Latin America aimed mainly at reducing future costs of pensions to the public budgets and hoping that such systems will enhance later retirement. ILO studies, quoted above also point to high administrative costs and to expected low replacement rates, especially for women or other persons with short, broken careers and lower incomes (or those who – like self-employed – obligatorily contribute only a certain low minimum amount). Figures 8 and 9 show expected theoretical replacement rates for selected EU member countries as reported in their national pension strategy reports. It is obvious that not only countries that embarked so-called paradigmatic reforms will see replacement rates going down unless people contribute significantly longer and retire significantly later. From the examples of France and the Czech Republic one can see that even so-called parametric reforms may reduce future replacement rates significantly.

Figure 8. Theoretical gross replacement rates in selected EU member countries: Average earnings, 40 years of contributions, retirement at 65



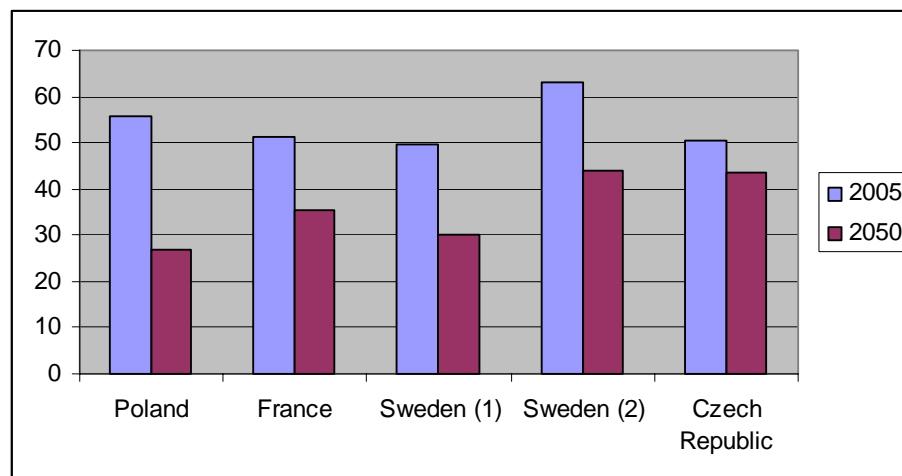
Source: own comparative analysis of data included in national pension strategy reports as available on:

[http://europa.eu.int/comm/employment\\_social/social\\_protection/pensions\\_en.htm](http://europa.eu.int/comm/employment_social/social_protection/pensions_en.htm).

Sweden (1): national pension system only; Sweden (2): including occupational pensions.

<sup>27</sup> See World Bank (2006): Pension reform and the Development of Pension Systems: An evaluation of World Bank Assistance, Washington, DC, pp. xvi and xvii.

Figure 9. Theoretical gross replacement rates in selected EU member countries: Broken career, only 30 years of contributions



Source: own comparative analysis of data included in national pension strategy reports as available on:  
[http://europa.eu.int/comm/employment\\_social/social\\_protection/pensions\\_en.htm](http://europa.eu.int/comm/employment_social/social_protection/pensions_en.htm)

Sweden (1): national pension system only; Sweden (2): including occupational pensions.

Figure 9 encapsulates the emerging new uncertainty. The general vehicle to accommodate revenue reductions is reductions in benefit levels. These reductions often result in added uncertainty for those hardest hit by global and national adjustment processes. The expected turbulences on national labour markets – with respect to changing patterns of work sharing in an increasingly globalizing labour market - and due to the global adjustment processes may lead to “broken” careers for many people. Such careers may be dotted with spells of unemployment or periods of retraining required by new conditions on the labour market. The above chart demonstrates that people with broken careers (i.e. with longer spells of unemployment, *inter alia*, due to increasing labour market volatility) will, in future, most likely face replacement rates that may no longer meet the requirements of ILO conventions.

Contrary to the demographic challenge, the potential detrimental effects of global tax competition on the level of social security in some countries are less easily manageable. It requires international agreements and insights that social security and notably the absence of poverty would be an investment in avoiding the resentment that creates national social unrest and potentially global security problems. The tools to achieve that situation are simply missing. Finding them remains a central challenge for the global society.

### ***Between universalism and pluralism: the changing pattern of solidarity***

On the other hand, there is increasing recognition of the role of social security as an investment in poverty alleviation.<sup>28</sup> There is growing support for a new social security developmental paradigm that is based on the introduction of basic universal benefits. The World Commission on the Social Dimension of Globalization has promoted the idea of a socio-economic floor for the global economy. The Director-General of the ILO in his Report to the ILC 2004 announced that the Office will further explore that suggestion and

<sup>28</sup> See Commission for Africa (2005), Ch. 6.

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will explicitly test the financial feasibility and deliverability of basic non-contributory pensions, basic health services and access to basic education.

Almost unnoticed, the global community has already assumed more responsibility for the provision of basic services in some developing countries. In Ghana and Tanzania, for example, direct budget support from donors, already accounts for substantial proportions (i.e. 4 per cent and 50 per cent respectively) of the national health budget.

At the same time the debate in some of the social security reform countries of the 1980s and 1990s reverts to a rethinking of the responsibility of the state for the provision of basic benefits reflecting deficient progress in terms of population coverage over the last decades.

Some say that the acceptance of the concept of solidarity is deteriorating as many social protection schemes are broken down into smaller and smaller risk pools (right down to the financing of risks by individual accounts). Others observe that the commonly accepted notion of solidarity is simply changing, now focusing more on the attainment of basic security for more people rather than equal security for a few. In any case, on the basis of a newly developing notion of solidarity, social security systems are becoming more pluralistic. Pension schemes are turning into systems where the basic public provision of income security mechanisms are topped up by social insurance or privatized savings arrangements where benefits have a much closer link to earned insured income, which, in turn, are topped up by voluntary or mandated arrangements. The consequence is a wide range of different income levels at retirement between different population groups.

In health care - the second biggest expenditure block in overall national social expenditure – pluralistic health systems emerge where the provision of basic services through the state is complemented by social health insurance schemes and community-based schemes. The World Health Assembly in May 2005 explicitly acknowledged the role of social health insurance schemes in national health systems.

Community-based schemes spring up everywhere in the developing world, most frequently in Africa and in parts of Asia. The global coverage of such mutual schemes is estimated to be about 40 million persons at the moment. There is certainly room for further growth and qualitative improvements of governance of these schemes. They cannot constitute or substitute a universal basic layer of security based on national solidarity. However, these insurance schemes can create an efficiency and quality-enhancing payer-provider relationship in the health sector. In addition, financial links (subsidies for the poor and underwriting of bad risks) have to be created with a central national or international agency to ensure the long-term viability of the scheme. The new health insurance law in Ghana is the first instance of which we are aware where this principle has been given legal force. Community-based insurance schemes have the potential to increase the overall resource base for social security and hence the fiscal space of the government. It also is – *de facto* – one way of indirectly taxing the informal economy. Or, in other words, of making the workers in the informal economy contribute to the financing of some state function. It is thus a step forward to the “formalization” of the informal economy and thus including them in some form of national solidarity. Community-based schemes also may play an even more important role in a handful of countries where nation states fail.

## **5. Changing the social security paradigm**

A comprehensive policy response is needed to address the above challenges. This policy response has to be developed by actors on the community, regional, national and international level. As a first prerequisite it requires a change in attitude towards social security. And, secondly, it requires a developmental vision for social security that can be applied to countries at different stages of development.

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## **Changing attitudes: From social cost to investment in people**

The ILO has always maintained that “*social security – if properly managed – enhances productivity by providing health care, incomes security and social services. [...] it is an instrument for social and economic development... It is noted that while social security is a cost to enterprises, it is also an investment in, or support for people. With globalization and structural adjustment policies, social security becomes more necessary than ever.*”<sup>29</sup> Social security or in a larger sense social protection (including social transfers but also safe and fair conditions of work, private social safety nets, etc.) is one of the main pillars of the decent work concept.

It is obvious that the adaptation of national labour markets to the challenges of demographic transition, new health hazards, global migration, changing family structures, changing values and globalization cannot proceed without investments in well designed social transfers that:

- maintain the productivity of workforces (notably ageing workforces) through investments in health care that, *inter alia*, combat new global health risks;
- facilitate adjustments in employment, *inter alia*, through facilitating training and retraining and job search and facilitating the integration of migrants;
- achieve a fair distribution of the proceeds of globalization and hence generate more acceptance of the process of global change;
- help to maintain social peace and global security that are prerequisites for stable long-term economic growth and hence creating the material basis for enhanced welfare for all.

It is difficult to perceive how the above can be done without investments in the build up and reform of sound properly managed and governed social security institutions. Some people may not want to believe that social security is a prerequisite for growth because we cannot show the exact logical causality. That is regrettable but the leap of faith is not needed. It suffices to accept the evidence that economic performance and solid social security can co-exist. We also know that these schemes reduce poverty and inequality and help people to adapt to changing circumstances in their own and the lifecycle of their society. In the end, what matters is people – and people are better off with social security.

The view of social security as a powerful tool to abolish poverty and, at the same time, as an investment in the long-term welfare and security of nations and the global community, requires a redefinition of the roles of individuals, communities, social partners, civic society at large, nations and the global society as agents of change. It also requires an active promotion of a basic human right to social security; it requires a revival of a rights-based approach to social security as one of the basic means of action of a comprehensive Decent Work policy agenda.

## **Building a global vision: Towards universal coverage**

The ILO is presently developing a coherent policy vision of country-specific effective and efficient national social security systems that countries at different levels of development can afford. The model has to be:

<sup>29</sup> cf. ILO (2001): *Social security – A new consensus*, p. 2.

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- (a) flexible, to accommodate national circumstances; and
  - (b) progressive, i.e. it has to permit a gradual build-up of more comprehensive systems as societies' mature (in an economic sense);
  - (c) accept the benefit levels and entitlements defined by ILO minimum standards (for example Convention No. 102) as an ultimate minimum level of protection.

When creating such systems, countries should seek to build on existing infrastructures and expertise in national social security institutions. The ILO's vision is:

- a. rights- and values-based;
- b. evidence-based and outcome-oriented;
- c. promoting universality and sustainability;
- d. promoting solidarity;
- e. insisting on the importance of social and national dialogue;
- f. confirming the central role and responsibility of the state while accepting systemic pluralism and sharing of responsibilities;
- g. promoting good governance;
- h. respecting national circumstances.

We believe that social security in the poorest countries can start with basic elements:

- Access to basic health care through pluralistic national systems that consist of public tax-financed components, social and private insurance components and community-based components that are linked to a strong central system.
- A system of family benefits that permits children to attend school.
- A system of self-targeting basic social assistance (cash-for-work programmes) that helps to overcome abject poverty for the able-bodied.
- Developing a system of basic universal pensions for old age, invalidity and survivorship that in effect supports whole families.

The following Box shows that even in the poorest developing countries - contrary to the widely held perception - some level of social protection is affordable.



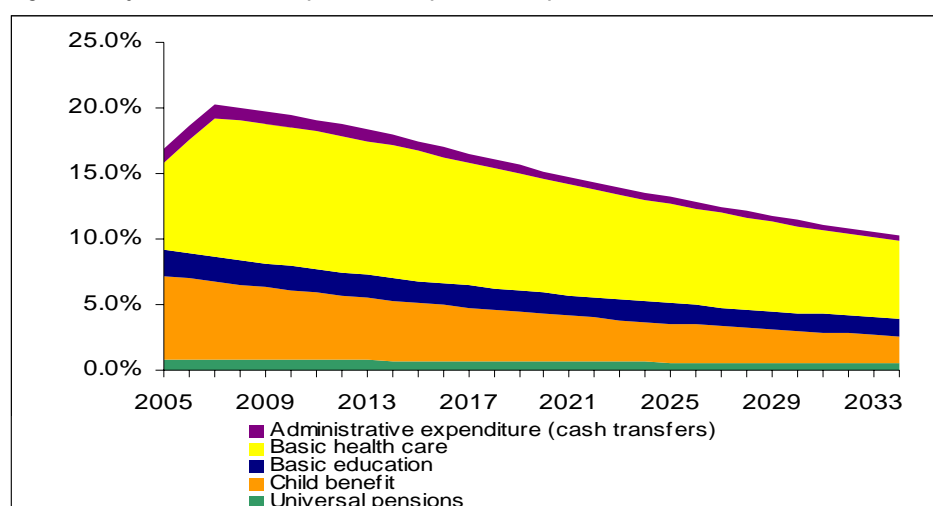
### Box . The affordability and impact of basic social protection in low-income countries in Sub-Saharan Africa

It has often been held that social protection was unaffordable for low-income countries, yet this judgment does not hold. Examples from a number of countries show that basic social protection programmes are feasible and have a marked effect on the reduction of poverty. A recent ILO modelling exercise has demonstrated that basic social protection benefits are not out of reach of low-income countries in Sub-Saharan Africa, even though some international assistance would be necessary for a transitory period.<sup>1</sup> Seven countries were included in this study, namely Burkina Faso, Cameroon, Ethiopia, Guinea, Kenya, Senegal and Tanzania.

A wide basic social protection package was assessed, including a universal old-age and invalidity pension, universal access to basic education, universal access to basic health care and a universal child benefit. Reflecting the methods used in the Millennium Development Goal indicators and other major international reports, the model assesses the cost of a universal old-age and invalidity pension of US\$0.50 (PPP) per day, UNICEF unit costs for primary education, per capita priority health care costs according to the Commission for Macroeconomics and Health and a child benefit of half the level of the universal pension.

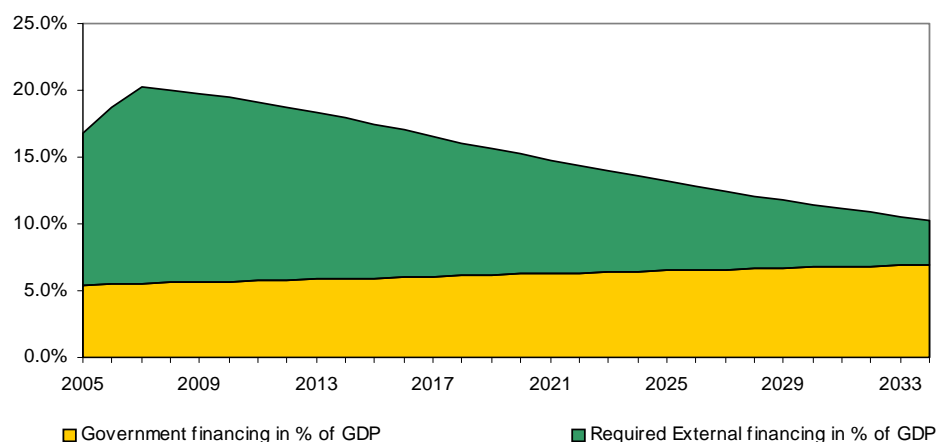
The results for the case of Tanzania (Box Figure 1) show that the total expenditure for a basic social protection package over the next three decades is projected to increase from 16.8 per cent of GDP in 2005 to 20.2 per cent in 2007, and would then drop to 10.3 per cent of GDP in 2034.

Box Figure 1. Projected basic social protection expenditure in per cent of GDP, Tanzania 2005-2034



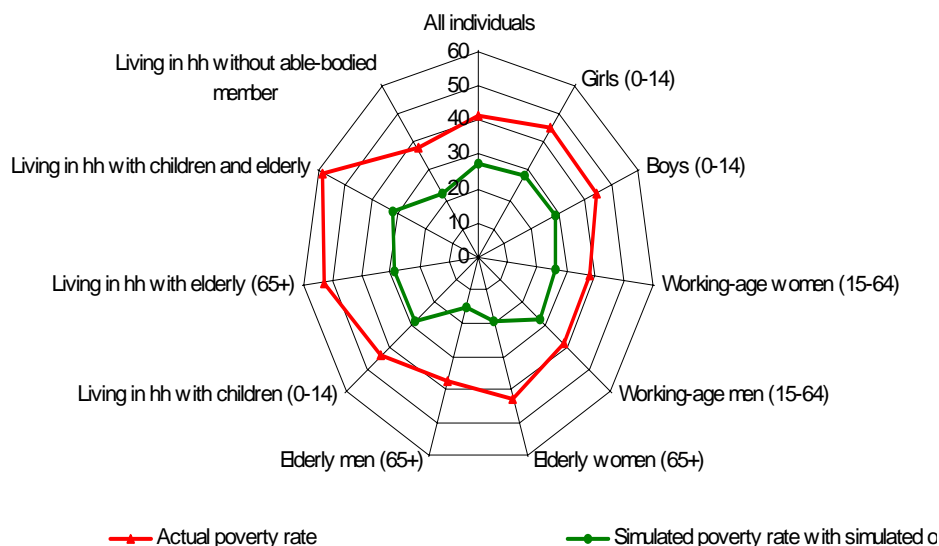
Under the assumption that expenditure on basic social protection would be equivalent to the 2003 proportion of government expenditure on basic social protection (i.e. 23.9 per cent), in 2005 domestic resources would cover approximately 32 per cent of the total cost of the basic social protection benefit package. In 2034 more than two-thirds (i.e. 68 per cent) of the cost of the package could be covered by domestic resources (see Box Figure 2).

Box Figure 2. Financing of basic social protection package, Tanzania 2005-2034 (based on assumption that 23.9 per cent of projected government expenditure is spent on basic social protection)



Such a basic social protection package would have a major impact on the reduction of poverty and the improvement of living standards. Access to basic social services, notably health care and education, undoubtedly has marked effects on increasing productivity and reducing poverty in the short and long run. In addition, cash transfers can play a major role in providing basic income security to those who do not have any earnings capacity, as shown for example in a GTZ-sponsored pilot project in the Kalomo district of Zambia.<sup>2</sup> Recent ILO micro-simulations show for the case of Tanzania that the combination of basic universal old-age pensions and child benefits to school children and orphans under the age of 14 would reduce overall poverty rates by about one-third (see Box Figure 3).

**Box Figure 3. Reduction of the poverty rate through universal cash transfers: Simulated poverty rates for the case of Tanzania**



Stepping up efforts to provide basic social protection is a viable way to reduce poverty and insecurity for countries in Sub-Saharan Africa, also in view of achieving the first Millennium Development Goal by 2015. The results of recent ILO research have shown that this can be both affordable and effective. This is a commitment which each individual nation needs to make, and some African countries have already committed themselves to enhancing social protection in their national poverty reduction strategies. Nevertheless, many countries cannot achieve this without external support for at least some time to come.

<sup>1</sup> See Pal, K.; Behrendt, C.; Léger, F.; Cichon, M., and Hagemejer, K., 2005: Can Low Income Countries Afford Basic Social Protection? First Results of a Modelling Exercise, Issues in Social Protection Discussion Paper 13 (Geneva, ILO).

<sup>2</sup> See Schubert, B., 2004: Social cash transfers - reaching the poorest. A contribution to the international debate based on experience in Zambia (Eschborn: GTZ).

As countries mature economically, higher levels of protection can gradually be achieved. The key objective is universality, i.e. achieving some social security as a right for all. That is the core mandate of the ILO's Campaign for the Extension of Social Security Coverage. The International Labour Conference in 2001 unanimously charged the ILO with conducting that campaign.

Universality does not mean uniformity. It is not realistic to believe that all societies can – left to their own devices – achieve the same level of social protection, even if the correlation between GDP levels and per capita social spending is weak. National social security systems inevitably have to grow with the fiscal space that is made available through increasing GDPs. What is critical, however, is that systems are in a rational way progressive, i.e. that they are addressing priority needs in a logical order and that they are built in such a way that the level of security can be augmented as economic development

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progresses. Within an overall national resource envelope, at different stages of development, contributions and taxes allocated to social security priority expenditures have to be defined. In developing countries they should be prioritized with respect to their contribution to achieve an acceptable level of health, their contribution to the reduction of poverty and their contribution to the reduction of social insecurity.

## **6. By way of conclusion: Accepting global responsibility**

*The above trends open up new opportunities and challenges for the global society. The acceptance of a global responsibility for anti-poverty policies as indicated by a global acceptance of PRSPs as a central vehicle for international aid and debt relief in exchange for strengthened national anti-poverty policies gives hope for the emergence of a global social solidarity.*

However, the biggest challenge is the international acceptance of a global responsibility for a global social policy that helps to create a fair sharing of the proceeds of globalization. To finance public expenditure for social protection and investment in decent work in general governments require fiscal space opened up by the ability to collect taxes and contributions from all citizens and enterprises. Government spending and fiscal policies are important general dimensions of the world of work. On the one hand, decent work requires a state of a certain size (size measured in terms of public expenditure as a percentage of GDP). It is simply impossible to implement decent work in countries where governments are not able to collect in taxes/contributions amounts necessary to provide for basic public and social services to its citizens and for basic infrastructure.

If globalization leads to tax competition that would limit the fiscal space for social transfers, then a “decent globalization” would require global measures to prevent that. To finance such public social expenditure governments need to collect taxes and contributions from workers and employers, from citizens. Government spending and fiscal policies are important dimensions of the world of work. Not just because taxes and contributions affect incomes and economic decisions of workers and employers, but – which is at least equally important – because public spending and effective fiscal policies are major elements defining the room for manoeuvre of national governments.

If the global community embraces globalization on the one hand, and sets global goals in the social sphere on the other hand, it has to organize the global economy and the global society in such a way as to enable nation states to achieve nationally and internationally defined policy objectives. It would mean to search for ways in which the global community can protect the fiscal space of the nation state. This can be done in three complementary ways:

- A. By setting and finding ways to implement social rights and global minimum standards for social transfers addressing poverty and social insecurity and to halt the race to the bottom - when it comes to curbing social rights and social spending - at a decent level. ILO social security standards and core labour standards can be seen as a beginning of that global process to protect the fiscal space of social security systems. In the context of a revival of a rights-based approach to social security new and wider instruments defining and defending a “global social floor” have to follow.
- B. The global community can also increase the fiscal space of national governments through global subsidization of sound anti-poverty policies. The global community has just begun to accept that responsibility. PRSPs, debt relief, ODA through budget support signal a new beginning. More needs to be done. We may need a fund to support the creation of sound social transfer schemes.

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- C. However, agreeing on minimum national tax levels and social expenditure levels would make much of, but not all, global transfers superfluous. The international community should support national Ministries of Welfare and Finance in the design of effective and efficient resource mobilization techniques much more efficiently than today.

Perceiving social security not just as “repair” expenses in market economies, but rather as investment in long-term growth and resulting in diminishing long-term needs for global transfers, would help to create world-wide acceptance of such levels.

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