
The need for solidarity: Social security systems in times of crises

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Numerous aspects of the financial and economic crisis must be of deep concern to us all. Economic downturn threatens not only enterprises and employment but also savings and investments devoted to pensions and other branches of social security.

Workers around the world are likely to face a double threat – both to their jobs and to their social security, in the short and the long term, with the revenue bases of social security schemes contracting. Governments around the world have acted in recognition of the need to stabilize financial markets. However, an important further step will be to safeguard people's social security when they are at risk of losing their incomes. Otherwise, the cost of the crisis – originating in management and regulatory failures on financial markets – will be borne over-proportionally by workers in the formal and informal sectors and their families.

And no worker in this interconnected global economy is immune to the crisis. Autoworkers in Europe and North America are losing their jobs due to contracting demand. Informal sector rubbish pickers in the junk yards of India are losing income, because the price of recycled paper has fallen since the export industries in Asia are not using much packaging material as global trade declines.

1. *The nature of the impact of the crisis on social security systems*

Some of the impacts on social security schemes are obvious, starting with demands on unemployment insurance and social assistance schemes which will be suffering like all other social security schemes from the double burden of declining tax or contribution income and increasing expenditure due to increasing numbers of beneficiaries. As the financial crisis is turning into a full blown global recession, health systems, unemployment benefit schemes, as well as social assistance that are largely "Pay-As-You-Go" (PAYG)-financed, are facing immediate resource problems. There will be increasing demands for allowing early retirement through existing or ad hoc arrangements and in that way limiting effects of job cuts or unemployment. This will place additional burden on the finances of pension schemes – both those managed by social security institutions and occupational ones.

The effect that these developments have on contributors and pensions is not straight forward. It will most likely affect people who will retire within the next months and years the most.

In defined benefit schemes where pension amounts are calculated without regard to the level of reserves the immediate impact will be less than in defined contribution schemes where benefits guarantees are less effective by nature. However, long-term contraction of employment and hence the number of contributors will also force governments to downward adjustments in defined benefit schemes.

However, in fully funded pension schemes pension entitlements in some pension funds might be lost completely. If the crisis turns into a long-term downward adjustment of asset

prices, the outcome in defined contribution schemes will inevitably be lower benefits paid at retirement. Any prolonged suppression of interest rates and contraction of asset prices will lead to serious difficulties by way of destabilized annuity rates (prices) and management of annuity reserve funds. The size of the long-term effect will depend on the depth and the duration of the downturn of asset prices. If the present price reductions turn into permanent level adjustments then old age income will be reduced, if the downturn is short lived, the effect will be transitional.

However, the present picture is rather bleak. The Chief of the Congressional Budget Office in the US had already announced in October 2008 that public and private pension funds in the US had lost roughly US\$1 trillion, or about 10 per cent of their total assets. Since then the asset prices have dropped further. The value of the assets of Calpers – the California Public Employees' Retirement System – alone fell by about US\$50 billion from the end of February to October 2008 due to stock market prices and other losses, more than 20 per cent of the value of their assets. The public and private pension schemes in Canada, lost so far this year about 10 per cent of their assets - an amount equivalent to about 6 per cent of the national GDP. The Caisse de Depot in Quebec, the investment arm of the Quebec pension plan, lost about 25 per cent of its assets value in 2008. The Chilean pension funds lost between summer 2007 and 28 October 2008 about 27 per cent of the value of their reserves. In the UK pension funds lost about roughly 500 billion Euros between October 2007 and October 2008. Japanese private pension schemes reported a loss of 20 per cent of their assets in 2008. And the downward trend continues.

While these losses may not be permanent, they still show the vulnerability of pension levels in defined contribution schemes, notably for people that are close to retirement and whose savings portfolios might not recover during their remaining active life.

2. Policy responses so far

In crisis conditions, the provision of social assistance and social security benefits paid to unemployed workers and other vulnerable recipients act as social and economic stabilizers. Benefits not only prevent people from falling further into poverty, but also limit the contraction of aggregate demand, thereby curtailing the potential depth of the recession. This is the time to strengthen social security benefits, where systems exist, or to introduce systems, where no such system exists yet. It is critically important, that increasing resources for social security are included as part of the respective economic stimulus packages. Such transfers alleviate the risk of poverty immediately for those who lose their jobs or are not able to work while, at the same time, stabilizing the demand for goods and services produced by those who still have jobs.

Participants in the 8th European Regional Meeting of the ILO agreed on the particular role of social security in restoring economic and social stability during the crisis and beyond. There was also an agreement that governments should avoid cutting allocations to finance social security benefits; on the contrary, there is a clear need to enhance social security systems.

Governments have recognized the need, and are reacting using a variety of measures. In September 2008 the US Congress adopted an extension of unemployment benefits as part of a broader economic stimulus package to promote job creation and preservation, invest in infrastructure, and provide economic and energy assistance. The Job Creation and Unemployment Relief Act provides for a 7-week extension of unemployment benefits nationwide, with an additional 13-week extension for high unemployment states like Michigan (for a 20-week extension total). The new administration that took over in January 2009 has stated that this is itself insufficient and plans to further extend the

coverage of unemployment insurance, bringing part-time workers into eligibility and increasing benefit amounts.

Increased allocation to different social security programmes represents an important part of the European Economic Recovery Plan. In recommending the stimulation of demand in the short-term, this document states: “Measures that can be introduced quickly and targeted at households which are especially hard hit by the slowdown are likely to feed through almost directly to consumption, e.g. temporarily increased transfers to the unemployed or low-income households, or a temporary lengthening of the duration of unemployment benefit.”¹ Belgium’s budget for 2009 includes €0.6 billion for increased unemployed benefits and additional allocations to social security, Denmark plans to increase spending on short-term social compensations, Spain will spend an additional €1.1 billion on public works organized by municipalities, France will increase the allocation to the “revenu de solidarité active” by €0.8 billion, Italy will allocate an additional €2.5 billion for support to low-income families and unemployment benefits, and the Netherlands is budgeting an additional amount of €0.2 billion to increase unemployment benefits.² Germany has increased the duration of its in-work benefit for partial unemployment and is determined to increase the benefit duration further should the crisis prolong.

Additional allocations to social security are also part of the crisis response measures in many other countries. The People’s Republic of China has announced a financial stimulus package amounting to around US\$500 billion over 2 years (and has very recently announced an immediate addition of about US\$20 billion), which is expected to include measures of both direct social protection (for example, income and employment support to families with no member in work) and more indirect (construction of low-cost housing), while maximizing the utilization and effectiveness of existing social security funds, although few details have yet been publicized. In Vietnam, it has been announced that “the Government’s US\$1 billion stimulus package, to be spent next year, will particularly benefit social security programmes”.³

However, a much more difficult situation is seen in the many countries where only small minorities are covered by social security and where unemployment benefits or similar income support schemes are entirely lacking. Amongst the countries now turning to the IMF for support in the crisis conditions, the package of measures has been agreed on the specific basis that social “safety nets” will be strengthened; these include Ukraine, where increased spending equivalent to 0.8 per cent of GDP is envisaged, and Pakistan, where the corresponding figure is 0.6 per cent of GDP.⁴

However, short-term ad hoc reactions are only a partial answer. One of the consensus conclusions following the Asian financial crisis in the late 1990s was that with income support programmes in place the impact of the crisis would have been much less

¹ Commission of the European Communities (2008). COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN COUNCIL: A European Economic Recovery Plan (Brussels, p. 8).

² See: Saha, D.; von Weizsäcker, J. (2008). Estimating the size of the European stimulus packages for 2009 (Breugel).

³ See: <http://www.vnbusinessnews.com/2008/12/stimulus-package-to-focus-on-social.html>

⁴ See: “Helping Ukraine Avoid a Hard Landing” - IMF Survey online 10 November 2008 (<http://www.imf.org/external/pubs/ft/survey/so/2008/car111008a.htm>); and “Pakistan Gets \$7.6 Billion Loan from IMF” - IMF Survey online 24 November 2008 (<http://www.imf.org/external/pubs/ft/survey/so/2008/car112408c.htm>)

damaging. A more systemic strategy is needed to react to this crisis, increase preparedness for future ones and address the need to ensure the right to social security for all people.

3. Towards a new social security development paradigm

At the recent 8th European Regional Meeting of the ILO in Lisbon, the Director-General, Mr Juan Somavia, pointed out that “there was already a crisis before the current financial and economic crisis”. The ILO had started to sound the alarm years ago based on the findings of the World Commission on the Social Dimension of Globalization. As the Director-General also said:⁵

“Globalization was operating in an ethical vacuum, making it morally unacceptable and politically unsustainable. The economic upswing was not creating enough decent work. Inequalities within and between countries were widening. The role of markets was overvalued, the role of States undervalued and the dignity of work devalued.”

To strengthen national and international action aimed at bringing fairness to the globalization process, the International Labour Conference in June 2008 unanimously adopted the ILO Declaration on Social Justice for a Fair Globalization. The Declaration confirms that the ILO has the solemn obligation to further among the nations of the world programmes which will achieve the objectives of full employment and the raising of standards of living, a minimum living wage and the extension of social security measures to provide a basic income to all in need, along with all the other objectives set out in the Declaration of Philadelphia. It reminds us that the ILO has the responsibility to examine and consider all international economic and financial policies in the light of the fundamental objective of social justice.

Three things are needed. The first is a fundamental overhaul of existing social security systems and the correction of mistakes made during the last two decades in countries where social security systems are already fairly developed. The second and perhaps more fundamental task is to introduce sound social security systems in countries where only rudimentary systems exist so far. The third and most challenging task would be to combine these two measures into a coherent long-term development paradigm for national social security systems. The crisis bears the risk that we are only seeking short-term quick fixes to poverty and insecurity while neglecting longer term solutions that would help to correct the fundamental inequities in the global economy and society.

Correcting past mistakes

Corrections are needed first and foremost in pension systems. The vulnerability of pension levels to the performance of capital markets that was introduced in so many pension systems during the last three decades clearly was a mistake that stands to be corrected.

What is needed immediately is to protect the pension levels of people that are close to retirement. A minimum pension based on an assumed minimum rate of return has to be financed and or guaranteed by the state hopefully for a transitional period. The state may authorize pension schemes to reduce the level of capitalization for a transitional period, i.e. one should allow them to go into temporary actuarial deficit. This is probably the only realistic option at the moment – given global resource constraints. If asset prices rebound

⁵ See: Address by Juan Somavia, Director-General of the International Labour Office to the opening of the Eighth European Regional Meeting, Lisbon, Portugal, 10 February 2009.

at some point then the overall cost of the guarantees will be only a fraction of the momentary losses of pension assets.

In their observations in response to the crisis, the OECD experts⁶ have suggested that governments could play a more active role in managing risks associated with the payout phase of pensions and annuities, with the idea that they could encourage the market for longevity hedging products by producing an official longevity index. Other OECD experts' proposals included suggestions that governments should issue longevity bonds that "would set a benchmark for private issuers", while they "should also consider" issuing more long-term and inflation-indexed bonds. This move has already been taken by a small number of countries, most recently by the Danish Government with the release of a 30-year bond that was primarily bought by domestic pension funds and insurance companies.

But much more fundamentally, this is the time for a systematic overall reassessment of global pension policies. The ILO has a range of tools through which to address these needs, notably the social security standards (formalized in the relevant Conventions) which have been built up over many decades, and specify the way in which social security systems should provide such guarantees. It has never been more timely than now to refresh, to promote and to apply those principles. Appropriate guarantees can be applied to both PAYG and fully funded pension schemes, and (in principle) can be legislated by any government. As a concrete suggestion in this environment, we would now promote the establishment of a global pension commission to review past policies and reforms, to analyse consequences of the crisis and to agree on medium- and long-term strategies.

Building social security for all

Social security will effectively cushion the negative impacts of the crisis if its foundations based on solidarity are strengthened. The ILO is promoting the reshaping of national social security systems based on the principal of progressive universalism. We first seek to ensure a minimum set of social security benefits for all, or the social protection floor. Based on that floor higher levels of social security should then be achieved as the economies develop and the fiscal space for redistributive policies widens.

Based on the human right of access to social security, the principles enshrined in the ILO's Constitution and the relevant international labour standards, in particular the ILO's Social Security (Minimum Standards) Convention, 1952 (No. 102), the ILO identified the following basic principles that solidarity-based social security systems should comply with:

- (i) **Universal coverage of income security and health systems.** All residents (both permanent and temporary) should have gender-fair access to an adequate level of basic benefits that lead to income security and access to comprehensive medical care.
- (ii) **Benefits and poverty protection as a right.** Entitlement to benefits should be specified in a precise manner so as to represent predictable rights of residents and contributors; benefits should protect people effectively against poverty; if based on contributions or earmarked taxes, minimum benefit levels should be in line with the Social Security (Minimum Standards) Convention, 1952 (No. 102), or more recent Conventions providing for higher levels of protection, and the European Code of Social Security of the Council of Europe.

⁶ See: http://www.ipe.com/news/Crisis_wipes_3_2trn_off_global_pensions_UPDATED_29685.php

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- (iii) **Actuarial equivalence of contributions and benefit levels.** The benefits to be received by scheme members should represent a minimum benefit replacement rate, and a minimum rate of return in the case of savings schemes, and must adequately reflect the overall level of the contributions paid; such minimum levels should be effectively guaranteed, preferably by the State.
 - (iv) **Sound financing.** Schemes should be financed in such a manner as to ensure to the furthest extent possible their long-term financial viability and sustainability, having regard to the maintenance of adequate fiscal space for the national social security system as a whole and individual schemes in particular.
 - (v) **Responsibility for governance.** Societies, i.e. concretely the State in coordination with social partners should remain the ultimate guarantor of social security rights, while those who finance, contribute to or benefit from, social security schemes should participate in their governance.

As part of its constitutional mandate to promote “the extension of social security to all”⁷ the ILO is promoting a social protection floor, consisting of an essential body of rights, transfers and services that all global citizens should have access to. We are specifically working on the definition of a minimum set of social security guarantees that should be the social security part of that floor.

Our actuaries and economists have shown that such a set of minimum guarantees – consisting of income security for children, social assistance, inter alia, through employment guarantees for the active population, income security for the elderly and disabled, as well as access to essential health care – is affordable – at least partially – in almost all countries.

There is hardly anybody too poor to share.

Such guarantees are the most direct and effective instruments that a society has to reduce poverty. We can show that with an investment of about 4 per cent of GDP the poverty headcount can be reduced by up to 40 per cent in poor countries in Africa. Incidentally, domestic revenues in Africa have increased by an average of 4 per cent since Monterrey.

We are not dreaming when promoting basic social security for all. And we are not alone.

The ILO is just finalizing a meta-study – analysing about 80 individual studies – on the new cash transfer programmes that have sprung up in about 30 developing countries around the world during the last 10 years and which provide elements of a social protection floor. Led by flagship programmes, like *Oportunidades* in Mexico, *Bolsa Familia* in Brazil, the child, old-age, invalidity grant system in South Africa and the unfolding 100-day employment guarantee scheme in India, about 70 programmes are in operation world wide. They already reach between 150 and 200 million beneficiaries. Our study concludes that these grant systems have a positive impact on poverty, health and nutrition, social status or recipients (notably women), economic activity and entrepreneurial small-scale investments notably in agriculture, and do not even have marked negative effects on labour market participation of the poor population they serve. In short, these schemes create social integration. And they do so successfully.

It is time to multiply efforts.

⁷ See ILO Declaration on Social Justice for a Fair Globalization, Geneva, 2008, section I(ii).

And the international agencies and the donor community can help. They can help countries to build social budgets, and establish priority social needs, and identify the necessary fiscal space to finance transfers; we can train solid managers and financial analysts. The ILO has entered into such programmes in Ecuador, Nepal, Sri Lanka, Tanzania and Zambia and – with the help of the EU – we will add another five countries to that list within the year.

But higher levels of social security also need to be protected. As said earlier, solidarity-based minimum guarantees of income replacement need to be restored. These guarantees must be underwritten by nation states.

This amounts to no less than the definition of a new coherent economic and social development policy paradigm. The beginnings of a new paradigm are already emerging.⁸ It is obvious that only strong employment growth will in the long run build the fiscal foundations for a sound social protection policy. On the other hand, investing in social protection at early stages of economic development is an immediate contribution to the reduction of poverty but at the same time facilitates the utilization of the full economic potential of the entire workforce of the country. No social security system can exist without a functioning economy, but likewise no economy can function productively with a workforce that is hungry, badly educated, unhealthy, and permanently too socially insecure to make a commitment to enterprises and societies. It is obvious that a society has to invest in a basic mechanism of social security to ensure that people can become productive. Once basic employability is achieved higher levels of social security can be afforded as the economy grows and the fiscal space widens.

4. The way ahead

Widespread support is gathering for the policy position that countries can grow with equity, i.e. providing some form of social protection from early stages of their economic development onwards. The value of social transfers in development policies was since recognized in several international fora such as the G8 Labour Ministers' Meeting in Dresden⁹ in 2007. The 2006 ECOSOC High Level Segment Ministerial Declaration stated explicitly¹⁰ "... countries need to devise policies that enable them to pursue both economic efficiency and social security and develop systems of social protection with broader and effective coverage". It was also reiterated by the ILO Declaration on Social Justice for a Fair Globalization adopted in June 2008 by the International Labour Conference. The G8 Social Summit in Rome last month explicitly stressed the role of social protection systems as "counter-cyclical automatic stabilisers".¹¹

⁸ See for example: GB.294/ESP/4 (Social protection as a productive factor); Social Security Department: *Social security for all: Investing in social justice and economic development*, Geneva 2008 and also P. Townsend (ed.): *Building decent societies: Rethinking the role of social security in development* (Geneva, ILO, forthcoming).

⁹ See G8 Labour Ministers Conference: Shaping the social dimensions of globalization, Dresden, 6-8 May 2007, Chair's conclusions.

¹⁰ See United Nations, Economic and Social Council (E/2006)/L.8, para. 19.

¹¹ See G8 Social Summit 2009: People First – Tackling together the human dimension of the crisis, Chair's summary, Rome, March 2009.

The G20 meeting last month in London concluded:¹²

“We are determined not only to restore growth but to lay the foundation for a fair and sustainable world economy. We recognise that the current crisis has a disproportionate impact on the vulnerable in the poorest countries and recognise our collective responsibility to mitigate the social impact of the crisis to minimise long-lasting damage to global potential. To this end:

- *we reaffirm our historic commitment to meeting the Millennium Development Goals and to achieving our respective ODA pledges, including:*
- *...the actions and decisions we have taken today will provide \$50 billion to support social protection, boost trade and safeguard development in low-income countries...;*
- *we are making available resources for social protection for the poorest countries, including through investing in long-term food security and through voluntary bilateral contributions to the World Bank's Vulnerability Framework, including the Infrastructure Crisis Facility, and the Rapid Social Response Fund....”*

Under the chairmanship of the Director-General of the ILO, the UN's High Level Committee on Programme (HLCP) is developing a common ONE/UN concept for a social protection floor. The ILO and WHO are leading this effort. We are determined to build a coalition of international agencies and donors to start a concerted effort on building national capacities to plan and implement sustainable social transfer schemes on the basis of the social floor concept. We will need ISSA and all its member institutions when it comes to the implementation of the concept.

It is time for the ILO and the UN to act.

Solidarity and adequate social security are the keys to overcoming the current crisis. But they are also essential to ensure that the future global economic system is fair – and thus sustainable.

¹² Global plan for recovery and reform: the Communiqué from the London Summit <http://www.londonsummit.gov.uk/en/summit-aims/summit-communicue/>