

Meeting of the OECD Council at Ministerial Level

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**IT'S ALL ABOUT PEOPLE
JOBS, EQUALITY AND TRUST**

It's all about People
Jobs, Equality and Trust



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Introduction

1. **Promoting Jobs, equality and trust has long been on the policy agendas of governments around the world but the recent financial and economic crisis has brought them to the centre of the policy debate in many countries.** Almost six years since the onset of the global financial and economic crisis, many OECD countries are still trapped in a vicious circle of high and increasingly persistent unemployment and under-employment and deteriorating social conditions for the most vulnerable groups (including the low skilled, immigrants and youth). At the same time, governments are facing large fiscal imbalances that constrain the range of policy options available to them to respond to these challenges. This, in turn, is weakening citizens' confidence in government and public institutions, with a potentially negative impact on the effectiveness of policy measures to restore growth and employment.

2. **Other OECD and Key Partner countries have weathered the crisis better, without a major increase in unemployment.** Still, even in these countries there are worrying underlying tensions, largely associated with the quality of jobs - for some vulnerable groups - and more generally with the way the benefits of growth (and the costs of the recession) are distributed. Indeed, as documented in the OECD publication *Divided We Stand – Why Inequality Keeps Rising* (2011), even before the global financial and economic crisis, income inequality had been rising in most OECD countries, and remained at very high levels or was further increasing in the Key Partner countries, despite often strong economic growth. Thus, a number of countries are facing the immediate challenge of dealing with the economic and social outcomes of the crisis, but an even larger number has to tackle the longer-term trends in widening income inequality that have been putting strains on social cohesion.

3. **Addressing these short- and longer-term challenges to promote better outcomes in respect of jobs, equality and trust calls for a comprehensive strategy, involving a set of well-coordinated policies at both the macroeconomic and microeconomic level.** As a matter of urgency, improving labour market conditions and confidence in the short term is largely dependent upon a broader and sustained economic recovery. However, strengthening the links between employment, equality and trust also requires a deeper and longer-term perspective. While economic growth and job creation are obviously essential, supporting them on a sustainable basis needs a holistic policy strategy to promote equality of opportunities and a fairer distribution of the related dividends. At the same time, governments need to enhance the effectiveness of public policies at large through clearer objectives and goals, stronger institutions, better coordination across government structures, the proactive involvement of communities, more transparency in government and better communication on policy choices. Without trust in governments, public institutions and well regulated markets, public support for ambitious, innovative policies is difficult to mobilise, particularly where short-term sacrifices are involved and where long-term gains might be less tangible.

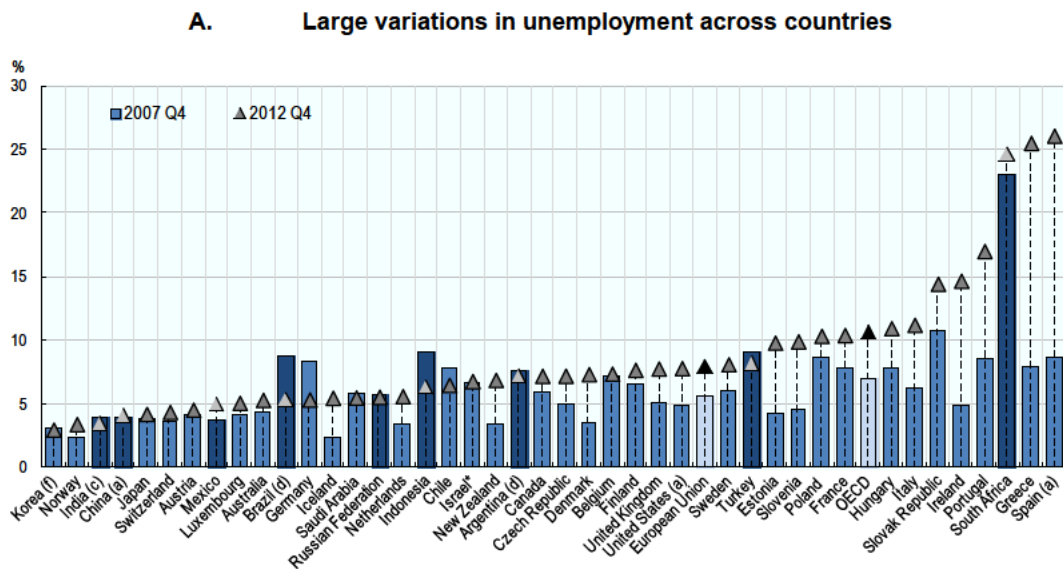
4. This report summarises the main short- and long-term challenges facing governments and presents policy options and institutional responses to build a new post-crisis social compact. **This social compact will help to define the responsibilities and actions required of governments and citizens to rebuild and sustain cohesive, fair and prosperous societies.** This paper proposes some of the constituent parts of such a compact for discussion by Ministers, including:

- Job creation and labour market policies;
- Investment in skills for employability;
- Strengthened social policies; and
- Better institutions and governance.

I. The diagnosis: a prolonged jobs crisis with widening social and institutional costs

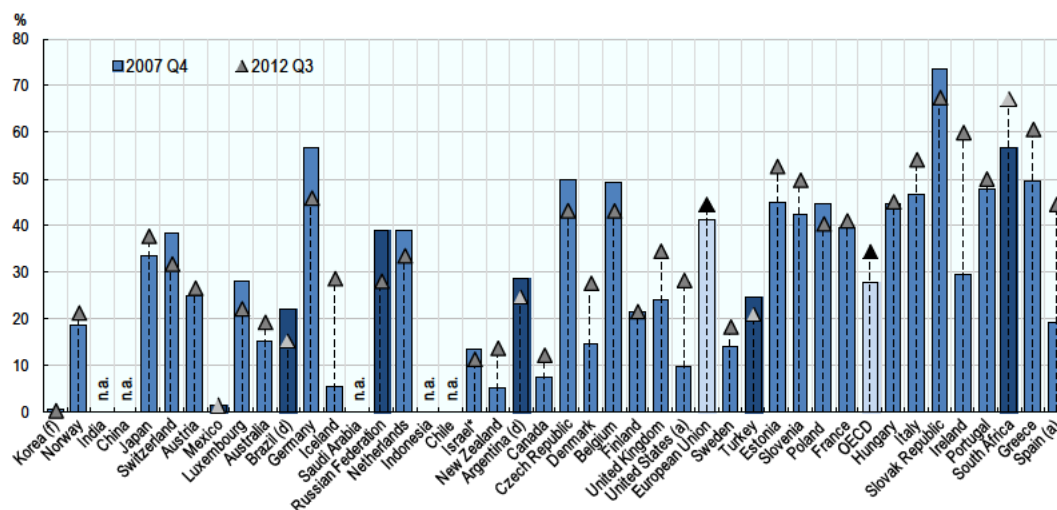
5. **In many countries, the labour market still bears the scars of the financial and economic crisis with persistently high levels of unemployment and underemployment, as well as rising long-term unemployment.** Youth, the low-skilled and immigrants have been hit the hardest. While in a number of countries the increase in unemployment is largely cyclical, there is a risk that high unemployment becomes structural. One striking feature of the global economic crisis and of the subsequent hesitant and uneven recovery has been the large diversity of labour market performance across countries (Figure 1). In several countries, the impact on employment has varied across regions, thus reinforcing spatial differences in economic outcomes that existed even prior to the crisis and calling for differentiated policy responses. On the one hand, substantial job losses were recorded in a number of advanced countries during the recession with weak job creation in the subsequent recovery. On the other hand, employment growth slowed but remained positive during the downturn in a number of other OECD countries (e.g. Australia and the Republic of Korea), as well as some Key Partner countries (e.g. China and Brazil). In many cases, flexible institutions and strong, coordinated policy responses have played a critical role in preventing rising unemployment. Social dialogue has also played a role in a number of countries, particularly in ensuring that employment and labour market policies, as well as vocational training and social protection policies, were adapted in line with the needs of the labour market.

Figure 1. The labour market effects of the Global Financial Crisis have shown a large diversity



B. Unemployment is becoming persistent in a number of countries

Incidence of long-term unemployment as a percentage of total unemployment (persons aged 15 and over^e), 2007 Q4 and 2012 Q3^f



n.a.: Not available.

Note: Countries shown in ascending order of unemployment rates in 2012 Q4.

*: Information on data for Israel: <http://dx.doi.org/10.1787/888932315602>.

a. Persons aged 16 and over for China, Spain and the United States.

b. 2007 for China; 2004/05 for India; 2007 Q3-2012 Q3 for Indonesia; 2007 Q4-2012 Q2 for Argentina; 2008 Q1-2012 Q2 for South Africa; 2007 Q2 and 2012 Q3 for Switzerland; and 2007 Q4 and 2012 Q3 for Greece, the Russian Federation; Switzerland; Turkey and the United Kingdom.

c. Annual estimated persons/person-days (in million) based on the current weekly activity status.

d. Selected urban areas.

e. Not seasonally adjusted data but smoothed using three quarter moving averages. Persons aged 15 and over for Argentina, Brazil, Canada, Japan and Mexico; 16 and over for the United States; 15-72 for the Russian Federation; 15-74 for the European Union, France, Germany, Italy, Turkey and the United Kingdom; and 16-74 for Spain.

f. Yearly data (2007 and 2011) for Korea; 2007 Q4-2011 Q4 for Israel.

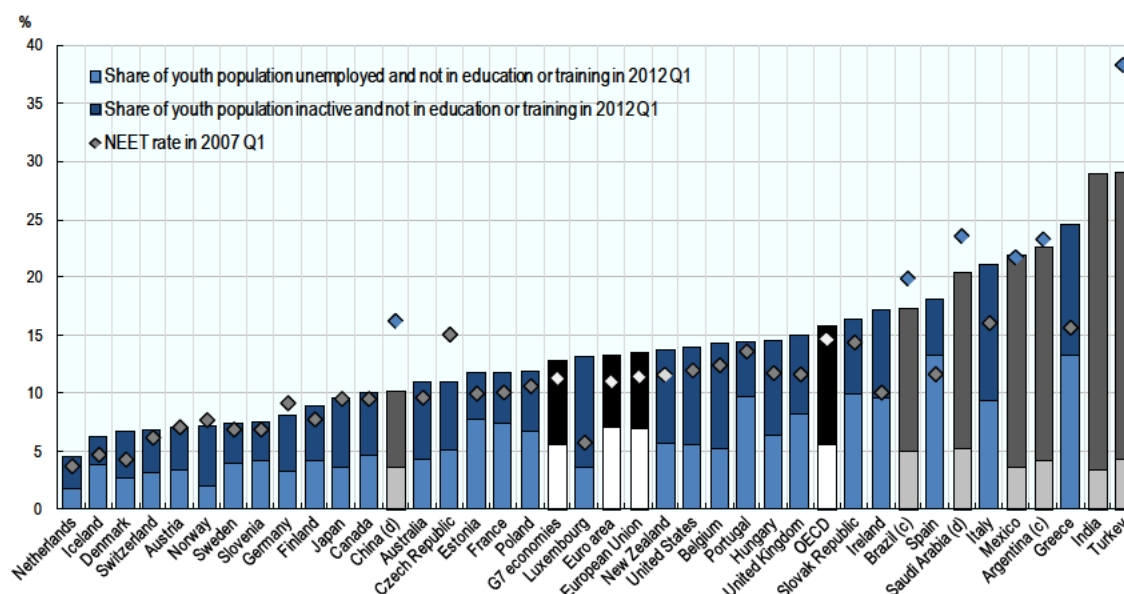
Source: OECD calculations based on OECD Short-Term Labour Market Statistics Database; and ILO, Short-term Indicators of the labour Market.

6. **Key to addressing the crisis is a focus on “job quality” as well as “job quantity”.** In a number of OECD and Key Partner countries, there are indeed concerns about the *quality* of jobs being created. For example, the crisis is impacting heavily upon the quality of jobs in many OECD countries, through greater job insecurity, lower opportunities for training and greater difficulties in reconciling work and family responsibilities, as well as greater financial strains for workers and their families from reduced earnings. In this context, women, the low skilled and immigrants stand out as particularly disadvantaged groups. In a number of Key Partner countries the economic recovery has not led to significant reductions in informal employment.

7. **One particularly worrisome feature, in this context, is the long-lasting effect of the crisis on youth and the risk of a lost generation.** Young people have been hard hit by job losses during the crisis and many school leavers are finding it very hard to find a first job opportunity. Joblessness encountered early in working lives can jeopardise youth long-term career paths and future earnings prospects (so called “scarring effects”). Youth not in employment, education or training (the so-called “NEETs”) are most at risk of scarring effects. The share of this group in the total youth population increased in the OECD area to 16.4% in the first quarter of 2011 (Figure 2). The increase in the NEET rate mainly reflects rising unemployment among youth, but in some countries with very high levels of unemployment, a number of youth have left the labour market and not re-engaged with the education system.

Figure 2. The dual challenge of bringing down high youth unemployment and giving youth a better start in the labour market

Youth not in employment, education or training (NEET) as a percentage of population aged 15/16-24,^a 2007 Q1-2012 Q1^b



Note: Countries are shown in ascending order of the NEET rate in 2012 Q1.

a. OECD, EU27 and euro area (17) are weighted averages. OECD includes 31 countries (excluding Chile, Israel and Korea).

b. 2009/10 only for India; 2005-10 for China; 2007 Q2-2012 Q2 for Argentina, Australia and Brazil; 2008 Q1-2012 Q1 for Norway, 2007 Q2-2012 Q1 for Switzerland; 2007 Q3-2011 Q4 for Saudi Arabia; and 2007 Q1-2011 Q4 for the United Kingdom.

c. Selected urban areas only.

d. NEET rate may include some unemployed people who are in education.

Source: OECD estimates based on national labour force surveys.

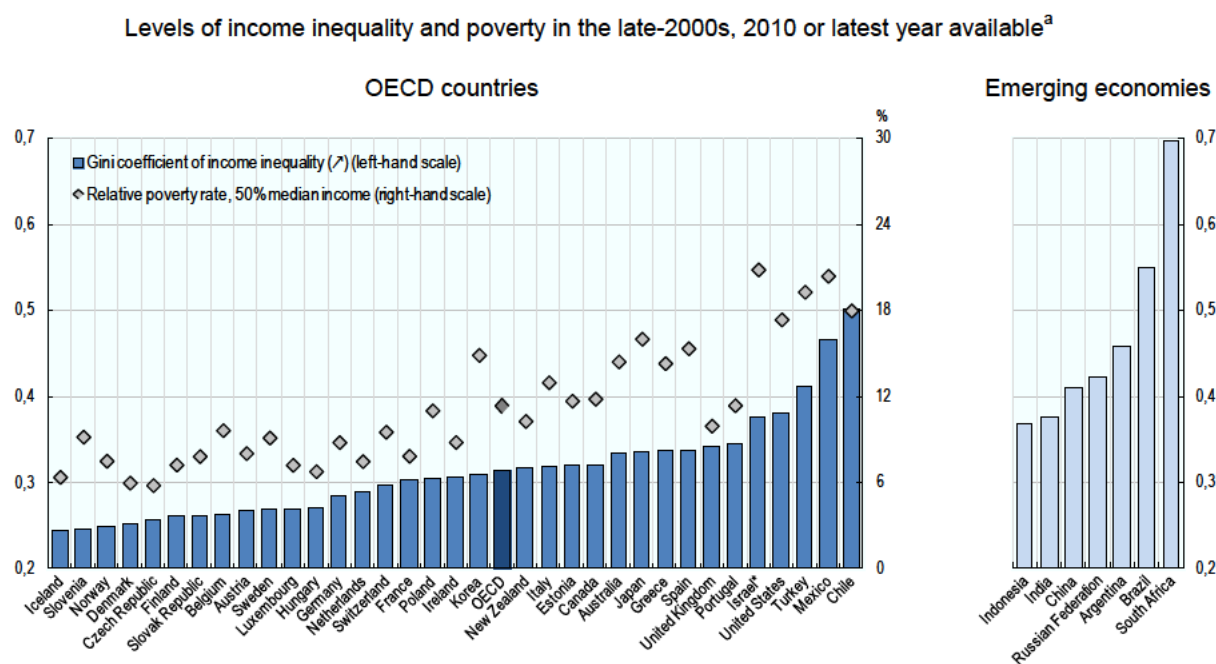
8. **In particular, high unemployment and inactivity among youth can exacerbate the skill mismatch.** Even before the crisis, many youth entered the labour market prematurely, without adequate skills and had to endure an often long and difficult journey before settling into a stable job with good career prospects. The integration of education and work experience can help youth to acquire both “hard” and “soft” skills that are generally better learnt on the job and promote long-term employability. If, on top of these pre-existing concerns, youth have limited opportunities to acquire work experiences, it becomes more difficult to reduce their skill mismatch (see Annex I on *Giving Youth a Better Start: An Action Plan*).

9. **Gender inequality was a persistent challenge even before the crisis.** In many countries women are often overrepresented in non-regular jobs and generally earn substantially less than men. The persistence of gender gaps in education, employment and entrepreneurship are not only an issue of equal opportunities for women, they also reflect an inefficient use of skills and competencies in our economies and societies. These gaps also point to a difficult social context in which women and men cannot easily combine their family life with their work aspirations.

10. **Labour market and social tensions associated with the crisis are adding to problems that pre-date the crisis, in particular rising income inequality.** Even in 2007, when the unemployment rate in the OECD area was at a record low level, and two-thirds of the working-age population were in employment, access to productive employment remained difficult for many individuals in vulnerable

groups. While some managed to find employment, these were often low-productivity jobs with limited career prospects that did not lift them permanently out of low pay and poverty. Workers in these jobs typically work few hours, or only for part of the year. At the same time, sharp increases in pay occurred for many workers at the top end of the distribution, leading to a widening of wage gaps in a large majority of OECD countries as well as many emerging economies (Figure 3). As a result, while access to employment improved in many countries prior to the crisis, this was often associated with a greater segmentation of the labour market.

Figure 3. Large differences in gaps between rich and poor across OECD countries and emerging economies



Note: Countries are ranked in increasing order of the Gini coefficient of income inequality. Data refer to the distribution of household disposable income in cash across people, with each person being attributed the income of the household where they live adjusted for household size.

Gini coefficients are based on equivalised incomes for OECD countries and per capita incomes for all EEs except India and Indonesia for which per capita consumption was used.

a. Data refers to 2009 for Hungary, Ireland, Japan, New Zealand and Turkey; 2011 for Chile. Data based on EU-SILC for 2010 are still provisional for Austria, Belgium, the Czech Republic, Estonia, Finland, Greece, Iceland, Italy, Luxembourg, Poland, Portugal, the Slovak Republic, Slovenia and Spain.

*: Information on data for Israel: <http://dx.doi.org/10.1787/888932315602>.

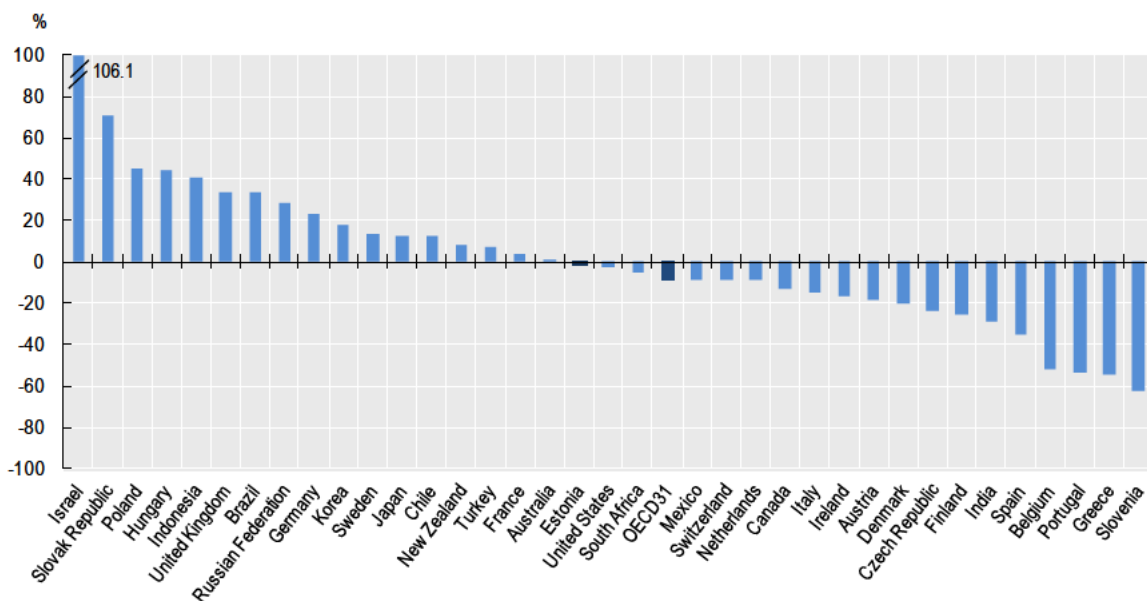
Source: Computations based on OECD income distribution database (www.oecd.org/social/income-distribution-database.htm).

11. **The pressure on the distribution of incomes is unlikely to ease in the wake of the crisis.** In the early phases of the crisis, the fall in capital incomes affected the well-off, while the stimulus packages cushioned the falls in incomes at the bottom of the distribution, leading to some easing in inequality. But more recently, high and persistent unemployment, as well as ongoing fiscal consolidation, are likely to add to income inequality, as many long-term unemployed are exhausting their rights to unemployment insurance and have to rely, at best, on less generous social assistance benefits (see Annex II on *The Social Policy Response to the Crisis*). At the same time, stock market prices have recovered thus boosting capital income at the top end of the distribution.

12. **In addition, the difficulty in tackling these economic and social challenges is hurting confidence in government and institutions.** There is evidence of a decline in trust in government in many OECD countries since 2007, particularly in those countries hardest hit by the crisis (see Figure 4). But trust

in government is not only determined by economic performance. Many other factors are at play, including the quality of public services, particularly in key areas such as health care, education and security, perception of corruption and factors relating to the political sphere. While fluctuations in trust, often related to economic cycles, are common, the current situation suggests a loss of trust in government that is deeper, more prolonged and more systemic than in the past. A *Forward Looking Agenda on Trust* is set out in Annex III.

Figure 4. Confidence in government, changes between 2007 and 2011 (Gallup World Poll)



Note: Percentage changes for those who answered “tend to trust” to the question: do you have confidence in the national government? 2006 data instead of 2007 for Austria, Finland, France, Ireland, Norway, Portugal, Slovak Republic, Slovenia and Switzerland. 2010 data instead of 2011 for Chile, Israel, Japan, and Brazil. 2009 data instead of 2011 for Switzerland. 2008 data instead of 2011 for Iceland and Norway.
Source: World Gallup Survey.

II. It’s all about people - policy options for jobs, equality and trust

13. **The initial response to the surging labour market and social tensions emanating from the crisis was to set up or strengthen support programmes to protect the most vulnerable.** In particular, strengthening income transfers and employment-oriented measures helped to cushion household incomes in the immediate aftermath of the crisis and, in turn, to support aggregate demand and employment. With a weak and uneven economic outlook, the first key policy requirement to restore confidence, growth and stimulate job creation, is to support aggregate demand.

14. **However, while social welfare needs have increased since the beginning of the global crisis, the fiscal space available to meet these demands has shrunk.** The majority of governments are embarking on fiscal consolidation to bring public debt down to sustainable levels over the medium term. Curbing the growth of social expenditures, which account for about half of total public spending in OECD countries, is often part of the fiscal consolidation process.

15. **In such a highly constrained financial environment, governments need to prioritise and combine policy measures in an effective manner.** Such a comprehensive policy package should include targeted measures for job creation and strengthened labour market policies, investment in skills for employability and more effective social policies. The effectiveness of these policies would be greatly enhanced if they are part of a comprehensive approach for strong and sustained economic growth.

Job creation and strengthening labour market policies

16. **In the short term, an important policy question concerns the extent to which governments can effectively address the rise in social needs in the face of increasingly tight fiscal constraints.** Policies to promote economic growth are a key to help addressing these challenges and they would bring in the dual dividend of stronger demand and higher revenues.

17. **At the same time, spending on cost-effective employment programmes and income support schemes targeted at the most vulnerable should be protected.** And even if taxes rise overall, there may be scope to reduce the tax wedge for lower income households. Unemployment benefits and social assistance have acted as automatic stabilisers during the crisis, with significant increases in spending driven by the rise in the number of unemployed people as well as social assistance for lower income households (though to a lesser extent and with more delay in the case of the latter). At the same time, however, effective support to the unemployed also requires adequate active labour market policies. OECD analysis shows that many governments scaled up resources for these policies following the onset of the crisis. However, these spending increases were modest in scale and the resources available per unemployed declined on average by more than 20% across the OECD area. More recently, unemployment insurance in some countries has become less generous, not least as a response to fiscal consolidation (see Annex II on *The Social Policy Response to the Crisis*).

18. **In this context, one crucial challenge for governments is to be smarter in the way they implement labour market policies, and to allocate labour market support to maximise results.** Job-search assistance and career guidance should remain the first line of support for many unemployed, especially those who are ready to take up a job. Education and training programmes, and even subsidised work-experience programmes, can help prevent long-term unemployed from becoming demoralised, while preparing them to take advantage of the new job opportunities when the labour market improves. Targeted job subsidies for new hires by employers that are tied to a *net* increase in jobs could also be considered in countries with very weak labour demand.

19. **Many OECD countries have responded to the crisis by introducing significant reforms to enhance the long-term growth potential and competitiveness of their economies, and to achieve fiscal sustainability.** Some have also introduced reforms to increase the flexibility of labour markets, over the past few years. As such, structural reforms typically take time to deliver their full benefits. These reforms should be complemented by investment in “New Sources of Growth”, like innovation, green growth and skills. More decisive action to foster job creation and opportunities, tackle skill mismatches and restore trust in institutions is also needed to make the process self-sustaining.

20. **Emerging economies require further measures to reduce informal employment and to improve job quality.** At first sight, informality does not necessarily translate into higher income inequality, because informal work complements household income, mainly at the bottom of the distribution. Nevertheless, persistent informality can lead to greater income disparities for many reasons. First, informal jobs typically carry a sizeable wage penalty, are more unstable and limit opportunities for human capital accumulation, career progression and access to social protection. Second, informality limits fiscal revenues and the scope for cost-effective extensions of social protection, especially to improve the coverage of the population most at risk of poverty and job loss. Third, employment in the informal sector can be detrimental to a worker’s subsequent prospects for formal employment, thereby increasing the worker’s risk of remaining in low-paid work and contributing to the persistence of income inequality. Most informal workers find themselves in the informal sector involuntarily.

21. **In many countries, there is also an urgent need to support disadvantaged youth.** A range of policies are required to tackle the multiple barriers hindering disadvantaged youth from gaining a durable foothold in the labour market. Strengthening initial investments in education and training is of paramount

importance for facilitating the transition from school to productive employment. Improving access to schemes that combine school-based learning with work-based apprenticeships can help, as clearly shown by low unemployment rates of a number of countries with long-standing dual systems. Job-search assistance programmes and career guidance are often the best way to help unemployed youth, while tailored training can help youth overcome their skills gap. But for the most disadvantaged youth comprehensive programmes are needed, including classroom instruction, on-the-job training and adult mentoring.

22. To reflect the urgency of tackling these challenges, one key feature of this year's Meeting of the OECD Ministerial Council is the proposal to **invite countries to commit to the key elements of an OECD Action Plan for Youth and to taking or strengthening effective measures to improve youth outcomes**. The OECD will then work with countries to implement the Youth Action Plan in their national context and report on progress at the next MCM in 2014. The details of the Action Plan are presented in Annex I on *Giving Youth a Better Start: An Action Plan*.

23. **At the same time, removing barriers to labour demand for youth requires that governments continue to pursue labour market reforms**. Particularly in countries where labour market dualism between regular and atypical jobs is relatively strong, this requires reforming job protection rules. Several European countries, such as Greece, Italy, Portugal and Spain, as well as Mexico, have recently adopted ambitious labour market reforms in this direction. If supported by efforts to tackle rising economic and social inequalities these reforms have the potential to boost job creation and improve the ability of the labour market to weather adverse economic shocks.

Strengthening investment in skills for employability

24. **The economic crisis has added urgency to fostering better skills**. The objective is to prepare young people and adults for life as well as work. In the context of high unemployment, the employability element needs to be underlined. Basic education needs to give more attention to employability, alongside traditional elements in the curriculum. Schools need to be more open to the world of work – whether through employer and trade union visits to schools, or work placements, or through career guidance more fully informed by an understanding of the labour market needs. The traditionally individualistic and academic ethos of schooling needs to evolve to integrate more effectively work-relevant skills, including a “team work” attitude, through project work to develop team working skills, and greater engagement with and through local employers.

25. **Often, vocational education and training systems need reform to improve their quality and status**. Such systems may also need stronger links with the labour market, more effective use of quality workplace training, whether through formal apprenticeships or in other ways, a training workforce with up-to-date industry experience, and qualifications that employers can recognise and use in recruitment. Vocational education and training systems need flexibility to respond to fast-changing labour market needs, while retaining a commitment to core transferable skills, including numeracy and literacy, that will strengthen their employability and enable their graduates to continue to learn and adapt in the future. Reforms need to be designed so as to support immediate labour market entry for young people, to underpin longer term career development and to enhance job quality. There may also be a need in many countries to expand opportunities for consultation with the social partners, which can pave the way to a better match between the skills that youth acquire at school and those needed in the labour market.

26. **Post-secondary education also plays a key role**. Increasingly, labour markets need skills and qualifications beyond upper secondary level. Postsecondary and tertiary education play a key role in many countries, both in ensuring labour market entry of young people, and retraining older adults for jobs, while also facilitating skill upgrading by displaced workers. Country approaches to education and training

provision, funding, quality assurance and qualifications are exceptionally diverse. Countries need systems that respond to the needs of diverse (often increasingly diverse) groups of learners, and to ensure affordable learning pathways leading to a job – whether through loans or other arrangements.

27. **Drop out needs to be tackled.** In places and times of economic boom, students can leave school early to take a low-skilled job. But in the current climate, students who do not succeed in school too often drop out, then move into unemployment or inactivity. And dropouts are only the most visible part of school failure: students that do not acquire good foundation skills will struggle in the labour market and to participate fully in society. Countries therefore need to reinforce the measures they are currently taking to reduce school failure and address dropout, including through funding strategies that are responsive to students' and schools' needs, a supportive school climate and environment for learning with high quality teachers, and additional educational support (e.g. remedial programmes, extra tutoring) to students who need it.

28. **The OECD Skills Strategy provides one instrument to help countries develop and implement better skills policies.** Endorsed by OECD Ministers in 2012, the OECD Skills Strategy underscores the need for a 'whole-of-government' approach to developing relevant skills, activating skills supply and making effective use of skills. As countries now working with the OECD to enhance their national skills strategies have found, better skills outcomes also require the active engagement of all stakeholders, including employers and unions. The OECD Survey of Adult Skills (PIAAC), which will be released in the first annual edition of the OECD Skills Outlook in October, will also provide important new evidence and insights for policymakers.

Strengthening social policies

29. **Over the past two decades, many OECD countries have introduced reforms aimed at fostering participation in the labour market, while protecting the poorest households.** These reforms included the closing of early-retirement schemes and strengthening incentives to work longer, but also the creation of in-work benefits to make work pay, the strengthening of activation principles attached to many non-employment benefits and the removal of non-monetary barriers to employment, such as access to affordable child-care and health care.

30. **The policy challenge now is to achieve growth-friendly fiscal consolidation while avoiding a reversal of these important reforms in a context of growing social needs.** Fiscal pressures on social programmes are substantial in many OECD countries, given their large weight in public spending on average. But social policies are essential for cushioning the damaging effects of the crisis and for supporting self-sufficiency. In this context, Annex II on *The Social Policy Response to the Crisis* stresses that, to be effective, such policies should account, as much as possible, for the circumstances of jobless individuals and other vulnerable groups.

31. **The annexed paper also underscores that social policies play a key role in supporting self-sufficiency and as such must take account the family situation of individuals.** Measures that safeguard child well-being, especially during the formative years of early childhood, are a high priority area. These policies can have positive spillover effects, notably by raising female participation in the labour market. Publicly provided services or goods are integral parts of a balanced approach to supporting vulnerable groups, such as children, long-term jobseekers, those with health problems or groups facing extreme economic hardship, such as the homeless. Public services can be especially important when high poverty rates make access to market-based services difficult for many people.

32. **Against a background of ageing populations, there is an urgent need to focus on how to provide better economic opportunities for all.** Strong, sustainable and inclusive economic growth can only be achieved if best use is made of all available human resources. In particular, leaving women behind

means not only forsaking the important contributions they make to the economy and society, but also wasting years of investment in the education of girls and young women. Gender equality is not just about economic empowerment; it is also about fairness and equity, and it requires addressing many political, educational, socio-economic and cultural dimensions which often exacerbate gender gaps. These findings and appropriate policy recommendations were presented in the Final Report to the 2012 Meeting of the OECD Ministerial Council on Gender Equality in Education, Employment and Entrepreneurship. Based on this final report, Ministers from OECD countries mandated updating, broadening and, where appropriate, strengthening the OECD 1980 Declaration on Policies for the Employment of Women to develop a Recommendation on Gender Equality for adoption by the 2013 Meeting of the OECD Ministerial Council. The implementation of the key elements of this Recommendation will be a significant step forward in the fight for gender equality.

33. **Over the past two decades, many countries have responded to population ageing by introducing reforms aimed at fostering participation of older workers in the labour market.** These reforms included the reduction, if not elimination, of early-retirement provisions, the increase in normal pensionable ages and the strengthening of incentives in the pension systems to work longer. But much remains to be done to foster employment opportunities for older workers and improve their employability. On the one hand, this requires improving incentives for both employers and workers of all ages to invest in training. On the other hand, however, seniority-wage structures, as well as very strict employment protection rules can have unintended consequences by discouraging the hiring of older workers. A strategy to enable older workers to stay longer in the labour market depends on a careful balancing act between these supply and demand side factors, while also eliminating all forms of discrimination against older workers.

34. **In most countries, there is also an urgent need to provide adequate responses to the pressures on health budgets.** In the fifteen years to the recent financial crisis, health spending per capita in OECD countries grew on average at a pace that was three times that of income per capita. The global financial crisis and the need to reign in large fiscal imbalances have led some countries to move into reverse. This has often been achieved by cutting wages and salaries of health workers and reducing prices paid for pharmaceuticals, but also by greater co-payments by patients for services, despite evidence that these can increase health inequalities. Going forward, it is expected that health spending will increase further in response to population ageing. But if this is to be the case, then it cannot continue to remain largely financed (70-80% of total) by the public sector alone, as at present, as it would be fiscally unsustainable. Many countries would have to manage the boundaries between the public and private provisions of health services in a way that does not exacerbate inequality in access and quality care. At the same time, while growing demand for health services will be a significant driver of new job opportunities, this would also require a reorientation of how countries pay health providers (doctors and hospitals) and pharmaceutical companies, to encourage appropriate, high-value services and innovation. This is becoming a critical policy challenge for OECD countries, but is also very pertinent to the emerging economies that are attempting to achieve universal health coverage (such as China, India, Indonesia and South Africa).

35. **Tax policies also have an important role to play provided that they are made more employment-friendly.** For example, expanding Earned Income Tax Credits (EITC) can improve incentives where there are disincentives to work (such as taxing pensions more favourably than earnings) these can be removed. Labour costs can also be reduced through (selective) cuts in employer social security contributions. Some governments are also re-examining their tax systems to ensure that wealthier individuals contribute their fair share of the tax burden. In the current context, any reforms would have to be designed with a view to maintaining if not increasing the overall tax revenue in order to tackle large budget deficits and high debt to GDP ratios. The most growth- and equity-friendly way to do this would be through reducing tax expenditures that favour the better off, increases in residential property taxation, and

increases in environmental taxes and possibly VAT, provided that this includes targeted social spending measures to cushion the effects on the poorest households.

III. The institutional challenge and response

36. **Economic recovery will be dependent on addressing the policy challenges referred to above, but also on strengthening the institutional setting and improving institutional effectiveness.** The crisis focused the world's attention on issues of regulatory management and public governance capacity, particularly in fast-changing, high-risk and financially sensitive sectors, and reawakened a debate on the need for strong and effective institutions in the economy. Protest movements in different parts of the developed world have questioned whether existing institutions in markets and governments support better prospects for them and whether the social compact in our societies continues to provide equal opportunities.

37. **The response starts from the recognition that strong government and effective implementation will require a cleaner, more strategic and forward-looking state that is committed to - and has the capacity for - policy implementation and compliance.** Even before the crisis, we observed that many governments were unable to advance meaningful reform agendas, partly due to lack of leadership or due to political economy constraints. On the other hand, in some cases, reforms have been approved, but a lack of institutional capacity created implementation gaps and hampered the effectiveness of such reforms. We therefore need to address all parts of the policy cycle including analysis, policy development and approval, implementation and oversight. The OECD has an opportunity to lead a policy debate on how greater trust in both public and private institutions and actors can contribute to the achievement of key economic and social objectives. The current economic and social context suggests the need now to think in terms of a Strategy for Trust. A forward looking agenda on trust in government would aim to identify the main measures to restore trust in government and confidence in public institutions and explore how the OECD can help governments to implement policies more effectively.

38. **Three important evolutions in the institutional landscape stand out with respect to the ability of the state to develop and implement policy:** (i) policy actions are closely interconnected, but co-ordination across policy areas is often extremely difficult; (ii) the effectiveness of regulations, institutions and structures has been "rediscovered" as a determining factor in economic and social policy success, rather than a mere detail and (iii) technology is fundamentally modifying the interaction between government and the governed -- but it has not yet brought the two closer together; perhaps even the opposite. Understanding how these three elements operate will help improve government effectiveness.

39. **First, it is important for governments to improve their ability to anticipate and manage complex policy challenges that pose a potential threat to the well-being of citizens and businesses.** This includes identifying and managing risks, planning for long-term change and dealing with multi-sectoral issues that cut across the structure of government. Governments need the capacity, tools and organisation to deal with such issues including through training, skills and competency development. Further work is needed in that respect. OECD work with Centres of Government and the High Level Risk Forum underlines the importance of strategic leadership from the centre with strong co-ordination across the whole of government.

40. **Second, more attention needs to be paid to the delivery of the policy agenda (the "how").** More equitable and inclusive policies can only be generated by a stronger and more inclusive policymaking process. This involves not only limiting the influence of narrow interests in policy decisions, but also proactively involving all relevant stakeholders in the search for better policy responses. Likewise, effective reforms and programs in the labour market and social protection will need to rely on sufficiently strong institutions for their implementation. As countries resolve to move ahead on the employment and

equity agenda, they will need to ask themselves whether they have the appropriate mechanisms for consultation and the institutions for implementation that can support policy initiatives in these areas. There is no shortage of good practice and concrete ideas in OECD and Key Partner countries to draw on for inspiration and this is an area where the OECD will be seeking to strengthen its analysis and advice.

41. **Third, restoring trust after the crisis and the societal changes brought about by faster communications, social media and a more vocal middle class requires more open and transparent government.** Today, access to information may not suffice. Governments must adapt to a more open environment and provide information that helps citizens better understand policy trade-offs. The OECD supports countries in this area by pooling standards, principles and assessment tools through its CleanGovBiz initiative. In addition, the OECD has closely followed progress in other international initiatives, such as the Open Government Partnership (OGP). The Organisation can move forward on this by improving its assessment tools and stepping up cooperation with the OGP.

42. **It is also crucial to improve the sense of fairness in policymaking, guaranteeing a level playing field for businesses and citizens.** The perception that money and vested interests exercise undue influence erodes trust and confidence in institutions. Efforts to tackle corruption should be reinforced, particularly in high-risk policy fields at the intersection of the public and private sectors. Undue influence on policy processes was highlighted by the crisis and now governments need to take visible steps to increase transparency in lobbying and reduce conflict of interest. Also in the context of the crisis, an analysis of whether political campaign financing is an efficient allocation of resources is an area which the OECD could explore. The Secretary-General has proposed further work in this field to help governments identify credible and effective actions (discussed in more detail in the annexed document).

43. **The effort at levelling the economic and social playing field should include addressing the perceived unfairness of tax policy outcomes.** There is a growing perception that governments are losing substantial corporate tax revenue because of international tax planning by multinational enterprises (MNEs) that enables MNEs to pay little or no tax by artificially shifting profits in ways that erode the taxable base to locations where they are subject to more favourable tax treatment. Base erosion and profit shifting (BEPS) constitutes a serious risk to tax fairness, tax sovereignty and tax revenues for countries around the globe. Because many BEPS strategies take advantage of the interface between the tax rules of different countries, it may be difficult for any single country, acting alone, to fully address the issue. A co-ordinated approach with the contribution of all stakeholders is needed.

44. **To break the cycle of deteriorating employment and social conditions, as well as waning confidence and trust, it is crucial to articulate consistent, mutually reinforcing policy responses, across the whole spectrum of economic policy, labour market reform, social policies and governance.** More effective protection from unemployment, active support for the youth, job-enhancing reforms and active social policies should be accompanied by greater efforts to set clear policy objectives and goals, improve coordination across government structures, ensure more openness and transparency in government, better communication of policy options, trade-offs and choices to citizens, and stronger and fairer institutions to deliver them.

45. **Altogether, progress in the generation of jobs, equity and trust can boost growth, promote well-being and help change the current mood of pessimism and excessive caution in employers, investors and consumers.** There is no shortage of good practice in the OECD to draw on for inspiration; what matters most now is to acknowledge that building a new post-crisis social compact will depend on the capacity to harness a common understanding between citizens and institutions.

ANNEX I. GIVING YOUTH A BETTER START: AN ACTION PLAN

Why action is needed

46. The global financial crisis has reinforced the message that more must be done to provide youth with the appropriate skills and help to get a better start in the labour market. Sharp increases in youth unemployment and underemployment have built upon long-standing structural obstacles that are preventing many youth in both OECD and Key Partner countries from developing the skills they need and being able to use those skills effectively through a successful transition from school to the labour market. Action is all the more urgent in the context of a hesitant economic recovery and weak job creation in many countries and at a time when governments face tight budgetary and financial constraints.

47. Tackling weak aggregate demand and promoting job creation are essential for bringing down high youth unemployment and under-employment. But while a brighter economic outlook will help, it will not solve all of the difficulties youth face in gaining access to productive and rewarding jobs; cost-effective measures addressing structural issues are also needed. Giving youth a better start in the labour market is not only vital for improving their well-being and fostering greater social cohesion but also for boosting potential growth and limiting future social expenditures, especially in the context of rapid population ageing in most countries.

48. Thus, action is needed both to bring immediate results in alleviating the current situation of high youth unemployment and underemployment and to produce better outcomes for youth in the longer run by equipping them with relevant skills for the future and removing barriers to their employment. Particular attention should be focussed on the most disadvantaged groups of youth, such as the low-skilled or those from migrant backgrounds, who face the greatest risk of becoming permanently marginalised from the labour market along with a range of social problems. Action should be applied across a broad front to improve the provision of basic education and vocational training, and social services, and to tackle labour market barriers more generally that are preventing many youth from gaining a firm foothold in the labour market. In line with the OECD Skills Strategy, effective action requires an effort across all relevant ministerial portfolios to ensure that youth acquire the right skills, bring those skills to the labour market and are able to utilise them effectively.

49. However, there are large country differences in the labour market situation for youth and thus policy responses must be tailored to each country's circumstances. This also opens up the scope for mutual learning from successful measures and programmes that countries have taken to improve youth employment outcomes. Much has already been tried: some initiatives have delivered good results while others have been disappointingly ineffective. Yet even where successful measures have been taken, every OECD and Key Partner country could still do more to improve youth outcomes.

50. Therefore, countries are invited to commit to the key elements of an OECD Action Plan for Youth (Box A1.1) and to taking or strengthening effective measures to improve youth outcomes. This includes actions to tackle the current youth unemployment crisis and strengthen the long-term employment prospects of youth. The OECD Action Plan for Youth draws together and builds upon extensive OECD analysis of education, skills and youth-related employment policies as well as a number of international initiatives, including the ILO Resolution on "The youth employment crisis: a call for action", the G20 commitments on youth employment and the EU Council's agreement on the Youth Guarantee.

51. Following its endorsement, the OECD will work with countries to implement the OECD Youth Action Plan in their national context and provide peer-learning opportunities for countries to share their implementation plans. The OECD will also provide a setting to discuss what works and what does not in an international perspective based on country experience and will report on progress to the MCM 2014.

Box A1.1. Key elements of the OECD Action Plan for Youth

Tackle the current youth unemployment crisis

- **Tackle weak aggregate demand and boost job creation.**
- **Provide adequate income support to unemployed youth** until labour market conditions improve but subject to strict mutual obligations in terms of active job search and engagement in measures to improve job readiness and employability.
- **Maintain and where possible expand cost-effective active labour market measures** including counselling, job-search assistance and entrepreneurship programmes, and provide more intensive assistance for the more disadvantaged youth, such as the low-skilled and those with a migrant background.
- **Tackle demand-side barriers to the employment of low-skilled youth**, such as high labour costs.
- **Encourage employers to continue or expand quality apprenticeship and internship programmes**, including through additional financial incentives if necessary.

Strengthen the long-term employment prospects of youth

- **Strengthen the education system and prepare all young people for the world of work**
 - Tackle and reduce school dropout and provide second-chance opportunities for those who have not completed upper secondary education level or equivalent.
 - Ensure that all youth achieve a good level of foundation and transversal skills.
 - Equip all young people with skills that are relevant for the labour market.
- **Strengthen the role and effectiveness of Vocational Education and Training**
 - Ensure that vocational education and training programmes provide a good level of foundation skills and provide additional assistance where necessary.
 - Ensure that VET programmes are more responsive to the needs of the labour market and provide young people with skills for which there are jobs.
 - Ensure that VET programmes have strong elements of work-based learning, adopt blends of work-based and classroom learning that provide the most effective environments for learning relevant skills and enhance the quality of apprenticeships, where necessary
 - Ensure that the social partners are actively involved in developing VET programmes that are not only relevant to current labour market requirements but also promote broader employability skills.
- **Assist the transition to the world of work**
 - Provide appropriate work experience opportunities for all young people before they leave education.
 - Provide good quality career guidance services, backed up with high quality information about careers and labour market prospects, to help young people make better career choices.
 - Obtain the commitment of the social partners to support the effective transition of youth into work, including through the development of career pathways in specific sectors and occupations.
- **Reshape labour market policy and institutions to facilitate access to employment and tackle social exclusion**
 - Ensure more equal treatment in employment protection of permanent and temporary workers, and provide for reasonably long trial periods to enable employers to give youth who lack work experience a chance to prove themselves and encourage transition to regular employment
 - Combat informal employment through a comprehensive approach.
 - For the most disadvantaged youth, intensive programmes may be required with a strong focus on remedial education, work experience and adult mentoring.

Where action should be taken

Youth have long faced challenges in the transition from education to work but now need urgent attention

52. Labour market outcomes for youth have been much poorer than for prime-age workers for most of the past two decades. Youth are more likely to be unemployed when in the labour force and when employed, they are more likely to be working in precarious jobs. Some youth who are neither working nor studying – the so-called NEETs – are effectively cut-off from improving their skills and risk becoming marginalised from the labour market and may turn to anti-social behaviour. These youth often suffer multiple disadvantages, they are typically very-low skilled, from low-income households and often from disadvantaged backgrounds, including being migrants or the children of migrants. Addressing this challenge requires a comprehensive set of policies, including actions on the labour market front as well as initiatives to provide training and remedial education.

53. Even when youth do manage to find jobs, they are also more likely than prime-age workers to have jobs that offer limited labour market stability, social protection and opportunities for training and career progression. In fact, as new entrants to the labour market, youth are frequently hired in temporary jobs in many countries. These can be stepping stones to more stable jobs but, when employment protection regulations and social security coverage differ substantially between permanent and temporary workers, they can create a two-tier or segmented labour market. Similar issues also apply in the Key Partner countries where a substantial proportion of youth are employed in informal jobs lacking social protection.

54. A higher level of education generally leads to better labour market outcomes. Nevertheless, some young university graduates face difficulties moving into paid employment or find themselves in jobs where they are under-employed (and may, in turn, crowd out lower-skilled youth). Their disappointment and frustration, having been told that higher education is the path to success, is magnified by the cost of their additional years in education and the burden of student debt. The co-existence of young unemployed or under-employed graduates, with employers who say they cannot find the people with the skills they need, suggests that there is scope to better link education systems with the world of work.

55. For some employed youth, mismatches between the skills they have and the skills that are required at work may be significant, especially for youth from a migrant background. Indeed, while skills mismatch can affect workers of all age groups, it can represent a daunting challenge when it traps youth in jobs that are not well-matched to their skills and aspirations, resulting in a depreciation and permanent loss of their competences.

Youth employment outcomes have deteriorated significantly following the economic crisis

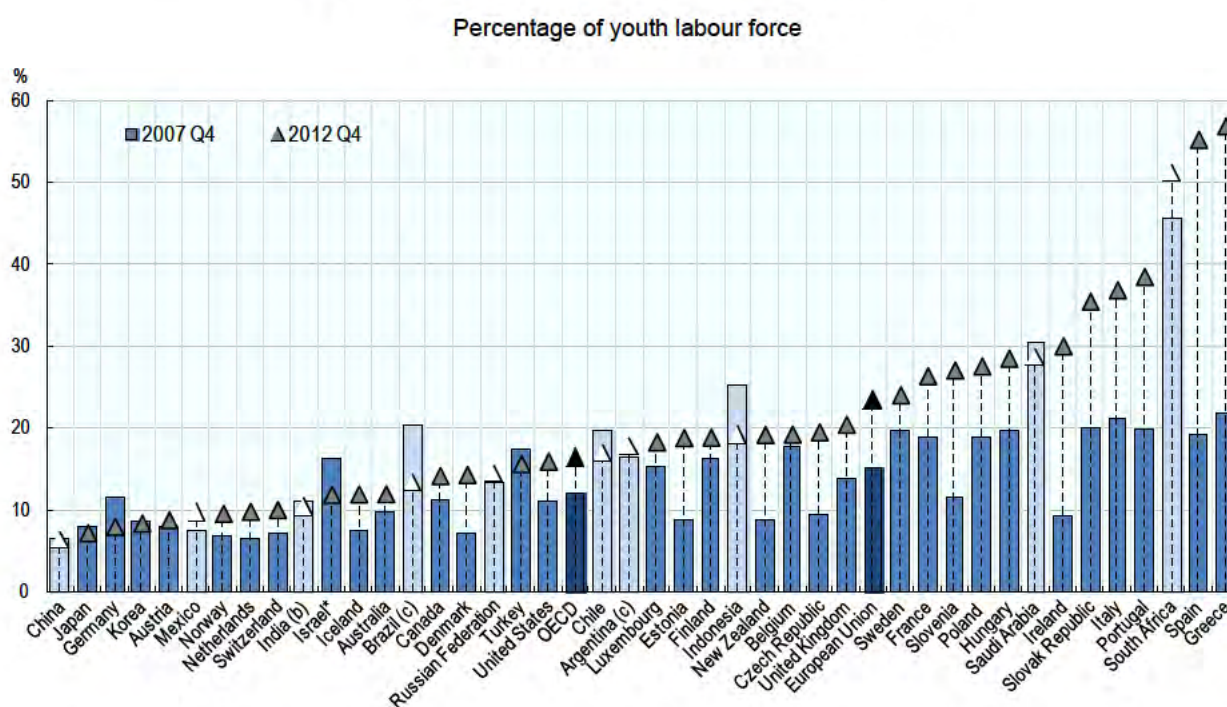
56. The economic crisis has exacerbated many of the challenges facing youth:

- The unemployment rate for youth (aged 15/16 to 24) rose substantially in most OECD countries and in a number of emerging economies and in many cases remains stuck at a higher rate even five years after the start of the crisis (Figure A1.1). At the end of 2012, over half of the youth labour force was unemployed in Greece and Spain but also in South Africa. Youth unemployment rates exceeded 20% in ten other OECD countries.
- The share of youth not in employment, education or training has also risen in almost all OECD countries, with the exception of the Czech Republic, Germany and Norway (Figure A1.2).
- The important role that skill levels play in employment outcomes can be seen in the sharp rise in the unemployment rate for youth who have not completed upper secondary school (or

equivalent), although even university graduates face tougher challenges to secure employment than before the crisis in most countries (Figure A1.3).

- The crisis has exacerbated issues of labour market segmentation in some countries. In many countries, there has been an increase in the proportion of employed youth (15/16-24 years) taking temporary work because they are unable to find a permanent job (Figure A1.4). In countries where the employment effect of the crisis varied across regions, territorial differences in youth labour market outcomes were intensified requiring differentiated policy responses.

Figure A1.1. Youth unemployment rates, 2007 and 2012^a



a) Or nearest year. Harmonised quarterly unemployment rates (seasonally adjusted) for all OECD countries, Brazil and South Africa; labour force survey estimates (not seasonally adjusted) for Indonesia and the Russian Federation; census estimates for China; and annual household survey estimates for India. Youth refer to persons aged 16-24 for China, Spain and the United States and to persons aged 15-24 in all other countries.

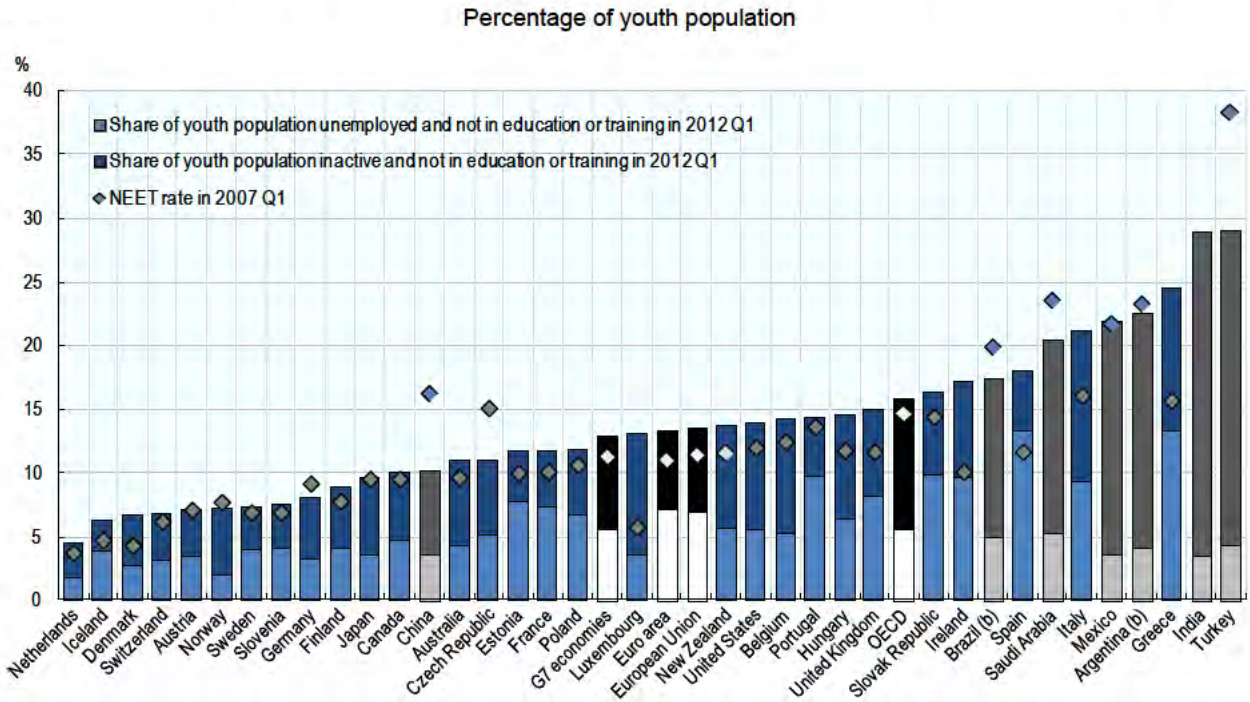
b) Annual estimated persons/person-days (in million) based on the current weekly activity status.

c) Selected urban areas.

*: Information on data for Israel: <http://dx.doi.org/10.1787/888932315602>

Source: OECD calculations based on *OECD Short-Term Labour Market Statistics Database*; ILO, Short-term Indicators of the labour Market; Census data for China and National Sample Survey for India.

Figure A1.2. Youth neither in employment nor in education or training (NEET), 2007 and 2012^a

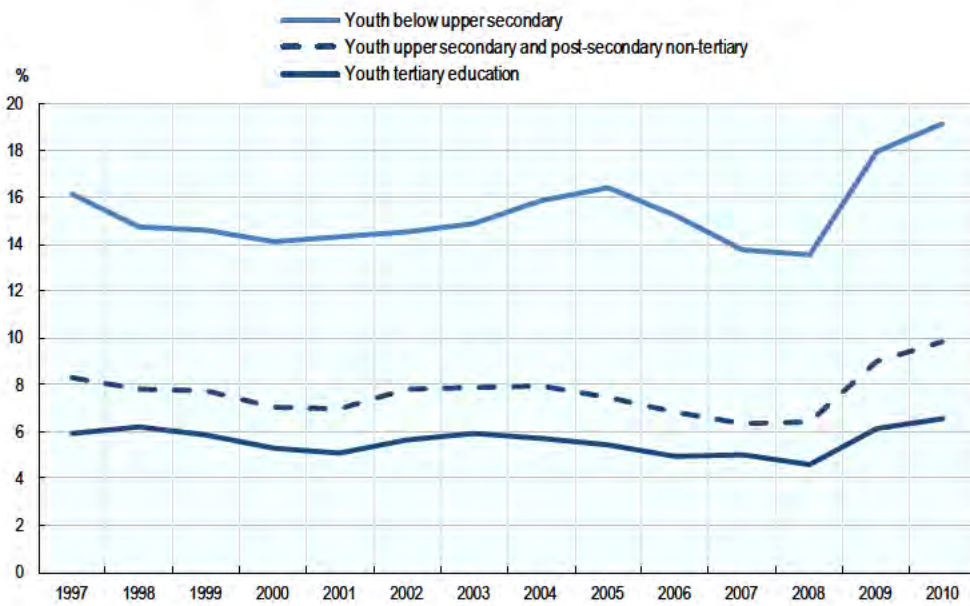


a) Or nearest year.

b) Selected urban areas.

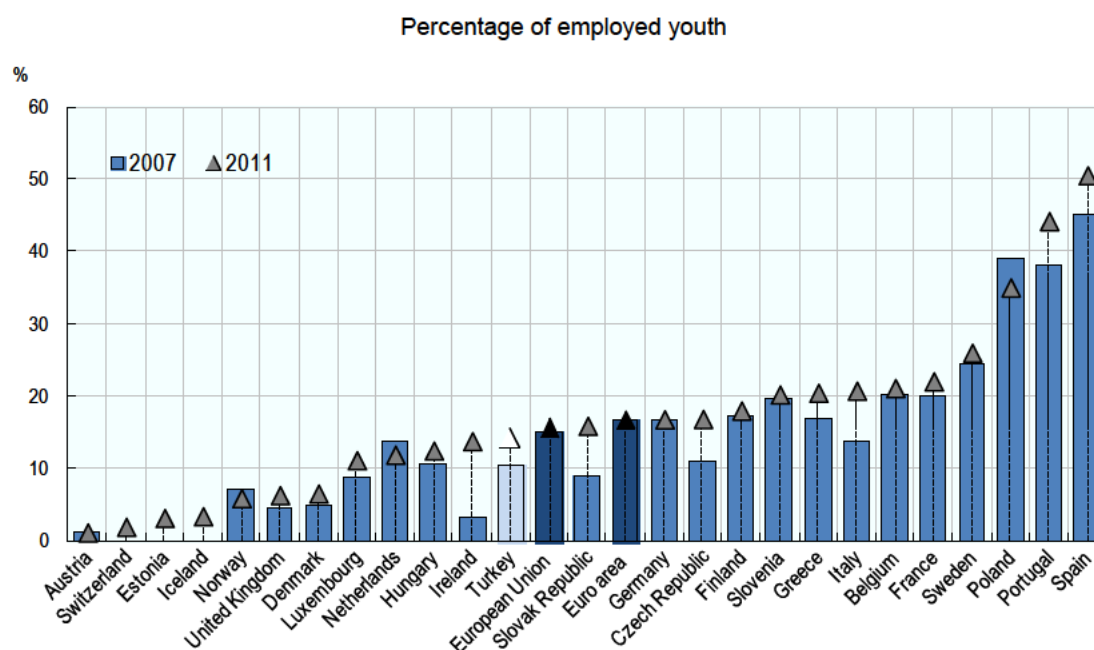
Source: OECD estimates based on national labour force survey, Education database for Brazil; Encuesta Permanente de Hogares (EPH) for Argentina; Indonesia Family Life Survey, fourth wave for Indonesia; General Household Survey for South Africa.

Figure A1.3. Unemployment rates for 25-34 year olds



Source: Education at a Glance, 2012

Figure A1.4. Incidence of involuntary temporary work^a among youth, 2007^b and 2011



a. The figures refer to the share of employees aged 15/16-24 who reported being in temporary jobs because they could not find a permanent job.

b. Data not available in 2007 for Estonia, Iceland and Switzerland.

Source: Eurostat.

What actions are needed

57. In the first instance, action must be taken to address the youth jobs crisis and which will have an impact on improving the situation of youth in the short term. Therefore, tackling weak aggregate demand and promoting job creation through appropriate macroeconomic policies should be a priority for action. However, this must be accompanied by action on the side of employment policy that will also bear immediate fruits, such as providing adequate income support, combined with effective employment services, and other active labour market measures or ensuring that conditional-cash transfer programmes in emerging economies reach youth most in need.

58. These immediate measures must be buttressed by action which addresses structural barriers to youth entering productive and rewarding jobs and which will have a durable impact over the medium- to long-term on improving the labour market prospects of youth. In this regard, concerted action across policy domains, as suggested by the *OECD Skills Strategy*, is crucial and must include: more effective investment in education and training to equip all young people with relevant skills; better connecting the worlds of education and work; and putting in place labour market measures which help younger workers to gain access to more permanent and rewarding jobs.

Labour market policies need to help tackle the current youth unemployment crisis

59. In the current context of weak economic growth and job creation in many countries, job seekers – and the young among them – need additional support. Even if public resources are constrained, especially in countries where fiscal consolidation is required, it is important to guarantee that youth, including those with little or no work experience, have access to unemployment and social assistance systems. At the same

time, cost-effective and well-targeted active labour market programmes should be stepped up to ensure that youth do not become discouraged and leave the labour force or move to the informal sector.

60. In addition, to strengthen employers' incentives to hire new workers, social security contribution rates need to be lowered or explicit wage subsidies introduced, particularly in countries where non-wage labour costs are high. In terms of implementation, across-the-board reductions in social security contributions risk incurring significant dead-weight losses and substitution effects, generating relatively little net employment gains at a significant fiscal cost. To ensure cost-effectiveness, reductions in labour costs could be narrowly targeted on low-skilled or other disadvantaged youth and could require that no workforce reduction occurs around the time of hiring.

61. Youth who have completed their education during the recent crisis or in its aftermath risk missing out on opportunities to acquire the work experience needed to get a permanent foothold in the labour market, particularly as crisis-stricken employers attempt to terminate ongoing work-based learning arrangements. Countries need to encourage employers to maintain or expand apprenticeship and internship programmes, including through additional financial incentives if necessary. For example, Australia has done so for both youth and employers in occupations facing skills shortages. Pre-apprenticeship programmes, such as in Germany, are also required to help early school leavers gain the minimum foundation skills required to gain access to apprenticeships or internships.

Too many young people leave the education system without an adequate level of foundation skills

62. Across OECD countries, PISA results indicate that almost one in five students do not reach a basic minimum level of skills to function in today's societies. Students from low socio-economic background are twice as likely to be low performers, implying that personal or social circumstances are obstacles to achieving their educational potential and their capacity to participate effectively in society. This contributes to an increase in school dropout rates, with 20% of young adults on average across the OECD dropping out before completing upper secondary education level.

63. Educational failure often starts early in the education process and needs a concerted policy response. Educational disparities are often already evident in early years and a sustained investment in identifying those at risk and providing them with effective additional education assistance is a crucial element. Finland does this particularly well, providing additional help to around one-third of primary school children at any point in time.

64. OECD work shows that student failure needs to be tackled at both the system and school level. At the system level, actions could include taking steps to: eliminate grade repetition; avoid early tracking and defer student selection to upper secondary education; and improve the quality and image of vocational education and training pathways. Actions to help disadvantaged schools could include steps to attract and retain high quality teachers, ensure effective classroom learning strategies and strengthen links with parents and communities.

While young adults who have dropped out also need a second chance option to strengthen their foundation skills

65. Given that attaining a threshold level of foundation skills is essential for youth to have any reasonable career prospects and to participate in society, it is very important that those who have dropped out of school feel they have some ways to return. Canada has a long-standing "second chance system" that enables young people to return and complete upper secondary school, while more recently, many European countries have developed a range of pathways back into education, which may be connected to the existing

secondary system, the vocational education and training system, adult education or designed as a stand-alone: what matters is that they deliver effective results.

66. The shape and design of second-chance programmes depends on the characteristics and needs of the youth concerned. Particular attention may be needed for youth from migrant backgrounds and those facing multiple social disadvantages. Where youth have experienced school failure from an early age and face multiple disadvantages, there are major hurdles to overcome and intensive efforts required to raise their skill levels. It is also important to recognise and validate relevant competencies they have acquired outside of the education system either to assist entry into further education programmes or to demonstrate their competencies to potential employers. In some cases, programmes will need to incorporate actions to address social barriers to labour market entry and issues such as housing and health. While providing second chance options may be expensive, the economic and social cost of doing nothing may well be significantly larger still.

Vocational education and training could play a stronger role in providing technical and general skills to promote employability

67. In many countries, vocational education has been an undervalued part of the education system for many years and has found itself overshadowed by the higher education sector. Yet modern vocational education and training is not just about traditional activities like plumbing or hairdressing but also about state-of-the-art skills in technology, ICT, logistics, creative arts and fashion, or social and personal services and increasingly includes sophisticated and advanced-level technical skills.

68. Well-designed vocational programmes, including apprenticeships which link work-based and classroom learning, equip young people with the skills that employers need, help to match young people to jobs, and form an important part of an effective skills strategy. The fact that countries with effective apprenticeship systems tend to see much lower youth unemployment and higher levels of educational participation also suggests that hands-on workplace training helps to integrate diverse groups of young people, encouraging them to stay in or re-engage with education and smooth the transition to work. At postsecondary level, effective vocational programmes prepare young people for higher level professional, technical and managerial positions. Indeed, in some countries, an emerging trend is for university graduates unable to find a job that matches their academic qualifications to then pursue a vocational education and training pathway.

69. Unfortunately, while leading-edge vocational education and training programmes are highly sophisticated and the competition for places is fierce, vocational education and training programmes in many countries are inadequate and have too often been a second-best, low-status option providing classroom-based programmes for academically weak students and unconnected to employer needs. This is especially prone to happen when where training providers receive funding for a fixed number of places determined without reference to demand for jobs, or where funding simply follows student preferences.

70. The most successful Vocational Education and Training programmes skilfully combine work-based and classroom learning. This measure in itself provides an important “test” of relevance: employer provision of workplace training should provide a signal that a programme is of labour market value. Workplace learning also facilitates a two-way flow of information between potential employers and employees, making later recruitment much more effective and less costly. It also allows students to acquire practical skills on up-to-date equipment and under trainers familiar with the most recent working methods and technologies and develop key soft skills – such as collaboration and dealing with customers – in a real-world environment. At the same time, the classroom setting can provide more theoretical knowledge, some broader employability skills and also foundation skills, where these need to be strengthened.

71. Workplace training, whether through apprenticeships or other models, requires a clear contractual framework that encourages employers to provide effective learning opportunities and enable trainees to make a productive contribution at work. Special contracts for apprentices or trainees exist in many countries and the apprenticeship or traineeship contract can underpin the quality of workplace training by setting out clearly the rights and obligations of both employers and trainees. More broadly, effective quality assurance mechanisms are needed to assure quality in apprenticeships and other workplace learning practices. This includes a well-functioning national system of competency-based qualifications to clearly identify both learning and labour market outcomes and to provide reliable and accessible information for both students and employers across different sectors and locations.

Exposure to the world of work while still in the education system is beneficial for all young people across all pathways

72. At all ages and stages, the education system could do more to help prepare young people for the world of work. While preparing students for the labour market is only one of the missions of the education system, it is nevertheless an important one. Yet student perceptions suggest scope to increase the relevance of schooling in preparing for the transition to work. PISA results show that in Japan and Korea, for example, just over one-third of 15 year olds feel that school has taught them things that could be useful in a job compared with close to 90% of students across the OECD as a whole. Almost one in four 15 year olds feel that school has done little to prepare them for adult life, and this rises to over 40% in Greece.

73. The education system can also play an important role in redressing imbalances in social capital, opening students' eyes to career possibilities that may be beyond their immediate social experience. Raising aspirations is a key element in promoting inter-generational mobility and is especially important for youth from disadvantaged backgrounds where most exposure is to low-skilled jobs. Developing the entrepreneurial skills of youth while still in education can also help to ensure a more fluid transition into the labour market.

74. Work experience can be built into the secondary experience, as in France, for example where all students are required to spend two weeks at a workplace at the end of 8th grade. At higher levels of education, internships provide another valuable opportunity to gain work experience, and are more often being built into degree structures. However, internships also need to be well-designed so as to ensure that they do provide a good learning experience and are not simply a means of cheap labour doing low-skilled work (and which in turn may crowd out a vital job opportunity for a low-skilled youth).

75. More flexible ways to combine work and study should also be developed, not least to provide young people with alternative ways of financing their studies. This can include new pathways being encouraged by professional bodies to combine employment and study towards professional qualifications. It also requires education and training providers to offer more flexible study options to accommodate part-time students.

Youth also need access to good quality information to make well- informed choices about education and career pathways

76. Youth need access to good quality information about career options, the skills they need to be successful in the workplace and about different educational pathways and where they lead. This includes not only information about likely labour market demand but also “reality check” information about what different jobs actually involve. Social media is already playing a role here, with a range of websites offering videos of individuals describing their jobs.

77. Many countries provide career guidance services but with rapidly evolving jobs and expanded career opportunities, choices are becoming harder making career guidance both more important and more demanding. If young people choose the wrong career or the wrong educational pathway, the costs of later changes can be high and PISA results suggest that young people lack confidence in making decisions.

78. Yet career guidance services have not always been as effective as they need to be. Weaknesses may include fragmented and under-resourced services; lack of relevant labour market information; guidance counsellors who do not understand how to use labour market information; advice that lacks objectivity; and career guidance initiatives that lack proper evaluation.

79. Good quality data analysis is needed to monitor the labour market outcomes of different education pathways. Surveys that monitor employment (and earnings) outcomes for graduates are useful information to prospective students and can help them to see which pathways are most likely to put them on a good career path. Prospective students in England can now easily find on a single website and in a common format, the graduate employment rates, along with a great deal of other information, for each programme at each higher education institution. Other countries such as France and Korea have developed similar websites.

80. Better data analysis of changing skills needs in the labour market is also needed to underpin effective choices. But although most countries in the OECD have elaborate skills forecasting systems in place, these have not always provided effective, timely and reliable indications of skills shortages and skills mismatches, or ensured that the information is easily accessible to those who need it.

Both passive and active labour market policies to help unemployed and disadvantaged youth need to be strengthened

81. A lack of access to unemployment benefits often means that youth are not supported by the Public Employment Services. Even when services are open to everybody, disadvantaged youth who stand to gain the most from the support provided, are hard to contact and engage. Widening unemployment benefits coverage to all youth including school leavers – even with a small payment, as it is the case in some OECD countries such as Australia, Belgium, Greece, Ireland, Luxembourg and the United Kingdom – would facilitate the provision of services. It would also allow the application of the “mutual obligation principle” whereby the benefit payment could be combined with strict job-search requirements and compulsory participation in effective re-employment programmes under the threat of moderate sanctions.

82. More generally, countries are confronted with the challenge of designing effective re-employment programmes for unemployed and other disadvantaged youth. This is far from easy and many programmes have yielded disappointing outcomes. Nonetheless, successful programmes appear to share some common characteristics. Job-search assistance programmes are often found to be the most cost-effective for youth, providing positive returns in the form of higher earnings and employment, while training programmes work best when they are carefully tailored to local or national labour market needs. In the United States the *YouthBuild* programme for disadvantaged youth focuses on training in the construction sector, with a focus on affordable and sustainable housing. Programmes to encourage or help youth start their own business may also play a useful role as well as measures to encourage greater geographical mobility.

83. Good targeting of the programmes is important and, to the extent possible given administrative capacity, it would be important to make participation in programmes compulsory for youth after a period of job search (e.g. six months). Programmes that integrate and combine services and offer a comprehensive package adapted to individual needs seem to be the most successful (e.g. Jobs Services Australia). For the most disadvantaged youth at high risk of social and labour market exclusion, residential programmes with

a strong focus on remedial education, work experience and adult mentoring – e.g. the Job Corps programme in the United States – have shown some positive outcomes, particularly for young adults.

Rebalancing employment protection for permanent and temporary workers and longer trial periods would help youth

84. More balanced employment protection for permanent and temporary workers is needed to enable employers to judge the vocational aptitudes and abilities of youth who lack work experience and encourage transition to regular employment. Strict and uncertain procedures concerning the firing of permanent workers along with high severance payments tend to make employers reluctant to hire youth on an open-ended contract. When this is combined with easy-to-use temporary contracts, inexperienced young people are hired mostly on short-term contractual arrangements, notably fixed-term contracts. These temporary contracts often represent a stepping stone into the labour market, opening the door to more stable employment later on, but there is a real risk that they may become traps when the gap in the degree of employment protection and non-wage costs between temporary and permanent contracts is wide.

85. Re-balancing the protection offered by different types of contracts would have positive effects for many low-skilled workers and those with intermittent employment spells, and hence youth are likely to be among the main beneficiaries. This would help youth (as well as other workers with limited work experience) to move gradually from entry jobs, which are often atypical, to more stable career jobs. In this context, some countries have either introduced (Chile) or are considering (Spain) a system of individual unemployment savings accounts that complement or substitute severance pay schemes. Distinct from the severance pay, the benefits are paid regardless of the reason or the initiator of the separation, and thus tend to reduce firms' defaults on severance payments. Moreover, since payments are prepaid, they do not hinder employment adjustment and simplify separation procedures. Less radical options include the possibility of limiting the use of temporary contracts more narrowly to jobs/projects of a temporary nature. However, this is already the case in some countries with a very high incidence of temporary work which suggests that moving further in this direction would require a significant increase in labour inspections and much stronger sanctions for non-compliance.

86. Finally, youth may benefit from trial periods of moderate length – approximately six months. This would encourage employers to hire young people on permanent contracts, as it would allow sufficient time for the skills of new hires to be tested.

Reductions in high labour costs can help low-skilled young people find a job

87. High labour costs can be a barrier to employment for youth, especially for those who are low-skilled and lack work experience. This can result from a mandatory minimum wage that is set at a high rate relative to average earnings and/or from high employer social-security contributions that add to wage costs.

88. While the minimum wage can play a useful role to ensure fair wages are paid and to help prevent poverty among workers, if set too high it could discourage employers from hiring low-skilled youth or encourage them to hire youth informally. To counter the potentially negative employment impact of the minimum wage on youth employment, minimum wage rates for teenagers (generally less than 20 year olds) are set at a lower level than the “adult” rate in several countries, including Australia, Belgium, Chile, India, Ireland, Greece (introduced in 2012), Luxembourg, the Netherlands, New Zealand and the United Kingdom. In France, lower rates also apply to youth (up to 17 years of age) with limited work experience and, more generally, labour costs for low-wage workers are reduced through lower employer social-security contributions.

89. The application of lower wages to young workers may be justified when the job offered includes a substantial training component. Examples of this include apprenticeship programmes in Germany and the United Kingdom, where starting salaries are lower in recognition of the lower productivity expected during the training period and subsequently increased as the training programme progresses.

Better incentives are required to encourage formal employment of youth

90. Combating informal employment requires a comprehensive approach in order to encourage firms to register their activity and their workers and strengthen the incentives for workers to seek formal sector jobs. The most important action is to improve the business environment for formal-sector firms, while at the same time strengthening the enforcement of the rules of law. On the labour market side, measures that may help promote the formalisation of employment include more transparent, simpler tax systems; less strict rules governing the use of temporary contracts; and enhancing the effective benefits that workers are likely to receive from social protection schemes. Effective enforcement of labour, tax and social security regulations is also essential to combat informal employment.

ANNEX II. THE SOCIAL POLICY RESPONSE TO THE CRISIS

Executive Summary

91. **Many OECD countries face high and often growing needs for social policies, alongside shrinking fiscal space, restricting the capacity for an effective response.** In the early phases of the global financial and economic crisis, social spending – which accounts for about half of total public outlays in OECD countries – increased, due to automatic stabilisers and fiscal stimulus packages. But in many OECD countries a shift in the fiscal stance is now taking place to tackle unprecedented deficits and debt-to-GDP ratios. Social spending is part of many fiscal consolidation plans, and pressures on social spending are set to increase further. Consolidation efforts are planned to be stronger in countries where social needs, as measured by declining in job prospects and rising in unemployment, have grown strongly since 2007.

92. **This happens in the context where many countries, over the past two decades, have introduced reforms aimed at making social protection systems more employment friendly, while protecting the poorest households.** Reforms to foster participation in the labour market included the closing of early-retirement schemes and strengthening incentives to work longer, but also the creation of in-work benefits to make work pay, the strengthening of activation principles attached to many non-employment benefits and the removal of non-monetary barriers to employment, such as access to affordable childcare and health care.

93. **In the major emerging economies, the impact of the global downturn on economic activity tended to be less severe and shorter in duration than in most of the OECD countries.** The context in which it took place also differed significantly. For instance, public finances were often in better shape in emerging economies before the crisis and, driven by a stronger economic recovery, government revenues continued to increase in most recent years. However, some of the OECD area experiences during the crisis are highly relevant in emerging economies that are seeking to develop sustainable and “crisis proof” social protection systems. Inequality and poverty continue to be major policy challenges in emerging economies, and social budgets are comparatively much smaller than in the OECD area leaving many workers and households unprotected from economic shocks.

94. **The challenges of securing adequate resources for social policy and, where necessary, of “doing more with less”, are therefore faced in OECD and emerging economies alike.** In emerging economies, structural and social reforms to improve the design and, importantly, the implementation of social protection, especially for the poorest parts of the population, need to continue. In both OECD and emerging economies, redistribution programmes require a sustained policy commitment, and a sound fiscal foundation that enables countries to provide support in a counter-cyclical manner when economic shocks do occur.

95. **The challenge in the OECD area now is to achieve fiscal consolidation while avoiding a reversal of important reforms in a context of growing social needs.** Fiscal pressures on social programmes are substantial in many OECD countries, given their large weight in public spending on average. But social policies are essential for cushioning the damaging effects of the crisis, and for supporting self-sufficiency. They also maintain and stabilise demand for goods and services, which strengthens growth and future employment gains. To be effective, policies should account, as much as possible, for the circumstances of jobless individuals and other vulnerable groups. Although fiscal challenges constrain the room for manoeuvre, maintaining adequate funding for employment-friendly social policies can contribute to a stronger and a more job-rich recovery.

96. **Particular attention should be paid to the design of consolidation measures, since there is evidence from past episodes that the resulting burden is not born evenly.** Where social programmes are well targeted, social expenditures cuts tend to affect the poor more than tax increases. But there are many different ways of cutting spending or increasing taxes, and the distributional consequences of cuts may be very different, depending on their design and on demographic factors specific to each country. There is still considerable controversy about the short and long-term effects of different consolidation measures but there is evidence that past consolidation plans tended to bear less on profits than on wage-earners, and had lasting effects on the latter. Simulation exercises of the impact of fiscal consolidation suggest that cutting income support programmes can have a substantial impact on low-income families if policy changes are not adequately designed. A critical issue can be how people respond to consolidation measures, and this is an aspect that existing studies have not addressed fully. For instance, across-the-board reductions in resources for childcare or employment-support programmes could delay employment and earnings growth during a recovery.

97. **Unemployment, general social assistance and active labour market programmes account for less than 10% of public social spending on average in the OECD, but during the downturn, additional demands were particularly strong on these programmes.** Margins for savings in this area can still be small in the current economic context, and reductions in benefit duration and recipient numbers should ideally be achieved in line with the pace of the recovery. Partially automatic links between benefit provision and unemployment levels, as in the US and Canada, are examples of an approach that can facilitate a counter-cyclical policy response, although discretionary policy responses in both these countries were significantly more substantial than these automatic changes. Both discretionary and automatic policy adjustments need to be designed carefully, in order to avoid unintended effects, such as hindering mobility between regions with high and low unemployment. In addition, insufficient resources, as in the case of unemployment insurance funds in many US States, can make it difficult to maintain effective income support during extended downturns in practice.

98. **During the early phase of the crisis, unemployment benefits have acted as crucial automatic stabilisers, limiting the negative impact of job and earnings losses on household incomes.** As job losses mounted, unemployment benefits provided a first line of defence against income losses, and helped to stabilise incomes of newly unemployed and their families. Most countries with strong out-of-work benefits in place have allowed them to operate to the full extent. At the same time, the United States and some other countries with more modest benefit levels or durations, have acted quickly to bolster existing income support measures. Countries where social policies were adapted at the onset of the crisis, such as France, Portugal or the United States, have prevented a steep rise in poverty over the period 2007-2010.

99. **But with increasing long-term unemployment, other types of government support have become crucial for averting steep increases in poverty and inequality.** The central role of assistance benefits as fall-back options for those not, or no longer, entitled to unemployment support should be a primary consideration when designing, timing and the implementing necessary fiscal consolidation strategies. Cash benefits should continue to adequately support families in hardship, and minimum-income benefits need to be strengthened where unemployment remains very high, and where those affected have little access to other forms of support. Likewise, publicly-provided services or goods are an integral part of a balanced approach to supporting vulnerable groups, such as children, jobseekers, individuals with health problems or groups facing extreme economic hardship, such as the homelessness. Reforms of cash transfers and health care services currently under way should prioritise protecting the neediest with adequate targeting of measures.

100. **The long-term unemployed, who are often heads of families with children, should continue to be targeted by social safety-nets, especially in countries where the recovery is slow.** Exceptional and targeted measures, such as temporary extensions of assistance benefits for the neediest or exceptional

food and housing supplements, can limit the rise in poverty. For instance, Finland recently enhanced its social and unemployment assistance programmes, while Austria reformed social assistance in a way that should be beneficial to families with children, and enhanced assistance benefits for unemployed in training. Low take-up of some key income replacement benefits for the working-age should also be addressed. In the United States, a series of measures before and after the onset of the crisis has made the Supplemental Nutrition Assistance Program (formerly “Food Stamps”) more accessible and, hence, significantly more responsive as a crisis safety-net.

101. Labour market activation strategies and suitably designed in-work support, including for part-time workers, should be maintained at a reasonable level, while the type, sequence and intensity of activation measures should be adapted to the evolving labour-market challenges. There is a strong case for designing government support in ways that harness and complement – rather than replace – households’ own capacities to adjust to adverse circumstances. The high fiscal cost of joblessness reinforces the case for well-funded active social policies, even if these are costly in the short term. But fiscal constraints may require a rapid transition from broad, stimulus-type programmes to selective and customised employment support. The best combination of policies will depend on labour market conditions as well. For instance, as the recovery gains momentum and promoting labour supply becomes more important, the focus of active labour-market policies should shift from labour-demand support towards in-work support for low-income working families. With large numbers of workless households, overarching objectives of “active” support include facilitating continued job search of all working-age family members, and ensuring that families benefit quickly once labour-market conditions improve. To be as effective as possible, work-related support should not be restricted to individual job losers, but directed at non-working partners as well.

102. Beyond immediate redistribution, the timing, sequencing and targeting of fiscal consolidation has longer-term consequences, although these are difficult to quantify and often disputed. For some areas of social spending, there is, however, strong evidence of distinct long-term benefits which should inform decisions on how to share savings efforts between different parts of health and social-protection budgets. In the health area, an important challenge is to achieve cost savings without compromising health outcomes and triggering even higher health-care costs in the future. Likewise, social policy measures that safeguard the wellbeing of children and youth – especially during the transition from school to work, and during the formative years of early childhood – are of particular importance and should be given priority.

103. Specifically, youth need to be actively supported to avoid long-term “scarring” effects. These “scarring” effects of labour-market detachment and of low-income spells mean that when the recession ends, its impacts on youth do not. Governments should react swiftly to the observed increase in youth poverty and joblessness, but support should be targeted and geared towards activation. A number of countries have already introduced specific support measures for unemployed youth (*e.g.*, Portugal), and some have adopted comprehensive strategies to offer a solution to all youth neither in employment education, or training (*e.g.* the United Kingdom, Denmark or New Zealand). The Youth Guarantee’s principles adopted recently by the EU Council go in the same direction. Ideally, under this approach cash transfers should be conditional on participating in vocational training, apprenticeship or other active programmes to provide youth with the skills required to access stable and good quality employment (see the recommendations in Annex I on “Giving Youth a Better Start: An Action Plan”). These programmes should also provide access to affordable health care. Implementing this strategy can be challenging because it requires planning - and financing – of additional infrastructure and training capacities. But if well designed and suitably evaluated, these investments can lead to higher employment rates and lower dependency on social transfers throughout adult life.

104. **Fiscal consolidation measures should avoid across-the-board cuts of important supplements such as housing and child/family benefits which can make a difference for poor working families and lone parents. Savings are achieved by reducing benefit levels, directly (e.g. Ireland) or progressively by de-indexing (e.g. Netherlands, United Kingdom).** This approach, however, should consider treating the most vulnerable families differently in order to avoid poverty and long-term consequences on child well-being. More effective targeting on low income families can help achieve substantial savings in the short-run while protecting the neediest. Targeting is a tool that needs to be fine-tuned, however, to avoid disincentives to work. Female employment has turned out to be very important for sustaining household income during the crisis. Changes to family-related programmes and other social benefits should be designed in a way that ensures that work brings financial gains for women and their families.

105. **Key structural reforms of social protection systems that started before the crisis should continue.** Successful reforms to pensions and health care systems are crucial for achieving fiscal consolidation while creating the necessary fiscal space to provide adequate support for disadvantaged groups. Pensions and health care each represent approximately 30% of total public spending in the OECD on average and reforms in these areas can have very substantial effects on the overall fiscal situation. As for pensions, short-term and temporary reforms, such as the freezing of benefit levels, can have an immediate impact on public finance, but they may also increase poverty risks for low-income elderly unless supplemental measures are taken in parallel. More structural reforms, aiming at restoring the long-term sustainability of pension systems, such as increasing retirement ages and lengthening the necessary contribution period can achieve larger savings, although with greater delay. While short-term fiscal pressures may put specific features of public pension provision into focus, it is important to consider retirement income provision more broadly. The recent economic crisis will affect the future retirement situation of the current working age population, and an important challenge is to identify reforms that may be effective in alleviating the impact of the crisis over time and how these reforms would affect fiscal consolidation. For health care systems, structural measures that reduce unnecessary supply of services and those that achieve savings through efficiency gains are better options than untargeted cuts (such as higher co-payments) that limit access to health services for the most vulnerable.

106. **In the very short-run, addressing these challenges requires more knowledge about the populations at risk, how these risks are likely to evolve in the coming years, who is currently protected and who will be left aside, and how various groups would be affected by specific policy reforms.** The crisis has highlighted the crucial role of effective income support and services, and the importance of organising both public and private provision of social policy in a cost-effective way. Information on who is and is not covered, and how both social needs and social-protection coverage will evolve in the coming years, is only partially available. So far, very few studies have examined the impact in the short- and medium term of fiscal consolidation plans on living standards and on social outcomes more generally. More work is urgently needed to gather evidence on these issues, and help build the right strategies and policy approaches that address both immediate social and fiscal concerns, as well as longer-term structural challenges.

Introduction

107. Many OECD countries face high and often growing needs for social policies, alongside shrinking fiscal space, restricting the capacity for an effective response. In the early phases of the global financial and economic crisis, social spending – which accounts for about half of total public outlays in OECD countries – increased. Social programmes acted as automatic stabilisers, supporting family incomes and demand for goods and services as unemployment and under-employment increased. Moreover, large fiscal stimulus packages were put in place in many countries, often including greater resources for social measures. But in many OECD countries a shift in the fiscal stance is now taking place to tackle unprecedented deficits and debt-to-GDP ratios. Social spending is part of many fiscal consolidation plans, and pressures on social spending are set to increase further.

108. As a consequence, countries are currently reviewing and reforming their social programmes. In some cases, income support for the working-age population is cut despite high levels of joblessness. Family supplements and child benefits are also under scrutiny. The crisis has also aggravated structural deficits of old age pensions and health care systems, triggering or accelerating reforms in many countries. Such reforms, as necessary as they may be, can have a substantial and immediate impact on households' income, depending on how they are designed and which groups they target. At the same time, the distinct long-term benefits associated with some areas of social spending mean that short-term savings from reduced investments can translate into significantly higher costs in the future. While most countries have so far avoided across-the-board cuts, careful attention should be paid to protecting the needs of the most vulnerable while fostering self-sufficiency.

109. In the major emerging economies, the impact of the global downturn on economic activity tended to be less severe and shorter in duration than in most of the OECD countries. The context in which it took place also differed significantly. For instance, public finances were often in better shape in emerging economies before the crisis and, driven by a stronger economic recovery, government revenues continued to increase in most recent years. However, some of the OECD area experiences during the crisis are highly relevant in emerging economies that are seeking to develop sustainable and “crisis proof” social protection systems. Inequality and poverty continue to be major policy challenges in emerging economies, and social budgets are comparatively much smaller than in the OECD area leaving many workers and households unprotected from economic shocks. The social policy challenges of securing adequate resources for social policy and, where necessary, of “doing more with less” are therefore faced in OECD and emerging economies alike.

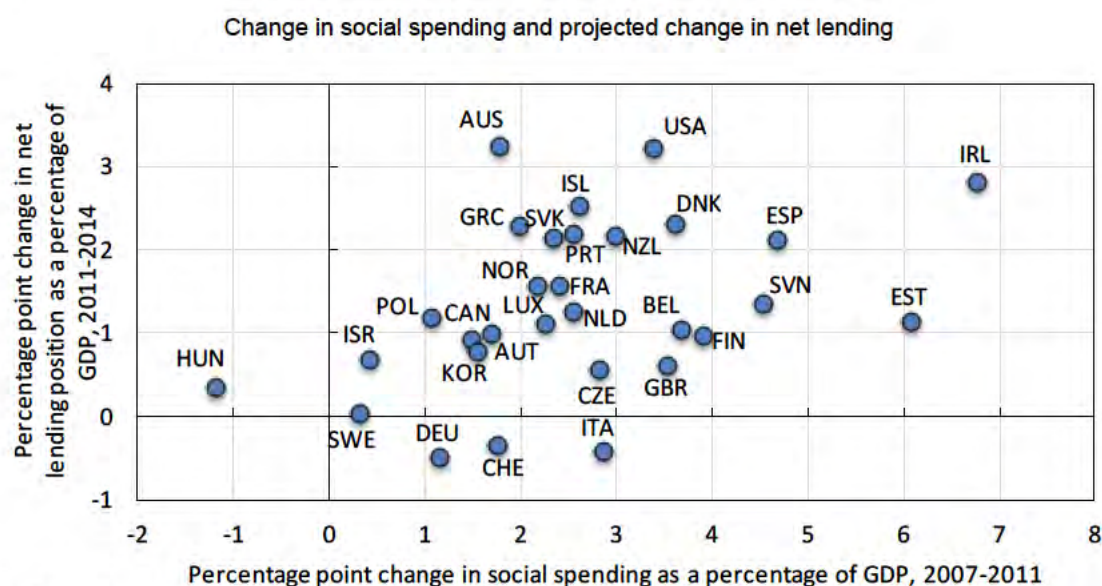
110. This paper reviews the evolution of social policies in OECD countries over the last five years and examines their potential impact in the context of high and increasingly persistent social risks. The paper also briefly summarises some of the most relevant social policy challenges in major emerging economies today, while acknowledging that these are not primarily crisis-related. The first section sets out the context of reforms in terms of fiscal space and social outcomes. The second section reviews how social spending has evolved since 2007 and what policy developments explain these changes. The third section gathers evidence on how fiscal consolidation has affected social policies and the likely impact on social protection, as well as on household income and health outcomes. The last section draws conclusions for policy makers and puts forward a set of policy recommendations.

I. THE CRISIS AND ITS AFTERMATH: DETERIORATED SOCIAL OUTCOMES

Fiscal space is shrinking

111. **Fiscal space is shrinking in most OECD countries, putting more pressure on social spending.** After reaching high levels in 2007, the net lending position of OECD governments has deteriorated sharply in 2009 and 2010. The OECD's latest economic projections for 2013 and 2014 show that government accounts will not come back to balance in the near future, except in countries which ran surpluses before the crisis (the Nordic European countries, Australia and Germany). Structural deficits, which had existed before 2008, widened due to the crisis and these imbalances will not disappear without further consolidation efforts. In 2009, 47% of total government spending went to social transfers and health services on average across the OECD (OECD Social Expenditure Database). The projected fiscal adjustment over the period 2011-2014 will be stronger in countries where increases in social spending were large since the start of the crisis (2007-2011, see Figure A2.1). For many countries, consolidation pressures will persist well beyond the next two years and could imply further substantial large consolidation needs in the 10-15 years horizon (Cournède *et al.*, 2013).

Figure A2.1. Fiscal adjustment is expected to be stronger in countries where social transfers increased most during the crisis

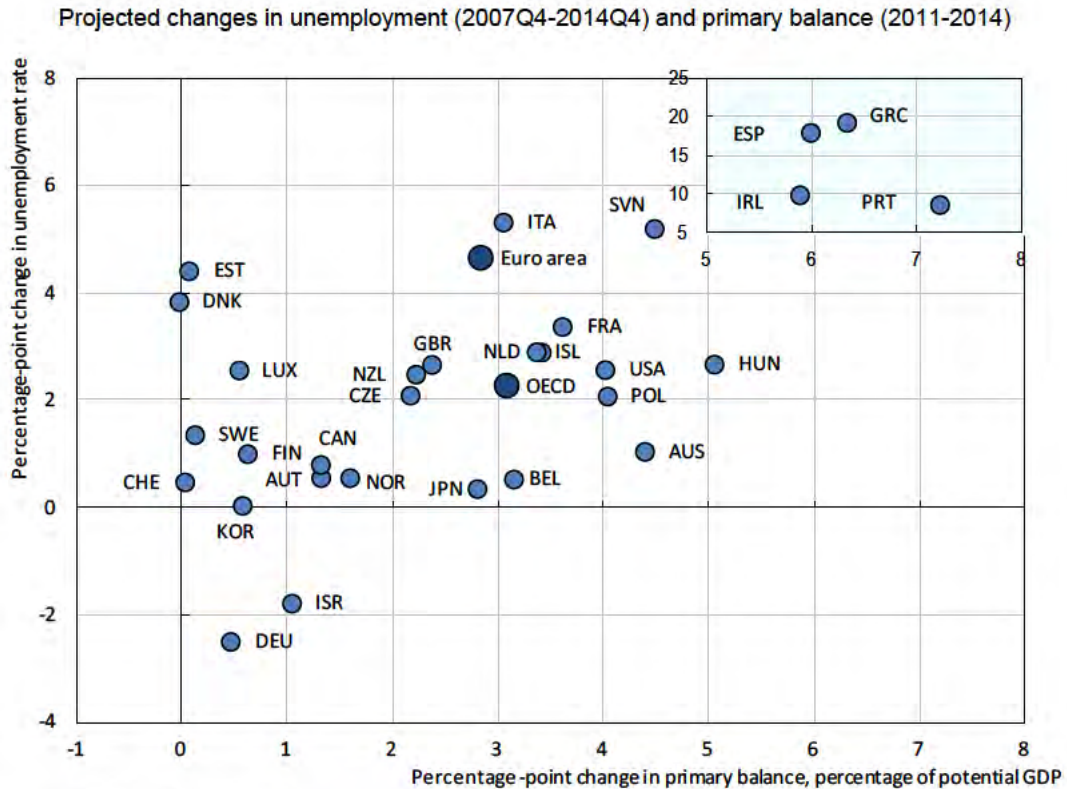


Sources: OECD Economic Outlook 92 database (www.oecd.org/economy/outlook/economicoutlook.htm) and projections based on the OECD Social Expenditure Database (www.oecd.org/els/social/expenditure).

Social risks are growing and becoming persistent for some groups

112. The increase in social spending reflects rising social needs. Unemployment has increased during the recession, and in most of the countries where it has increased significantly, it is still close to, or at its peak. (Figure A2.2). This is the case, in particular, in a number of Eurozone countries. However, to a lesser extent, this pattern also appears in other OECD countries. According to current plans, fiscal consolidation efforts tend to be stronger in countries which experienced steeper increases in unemployment. This pattern underlines concerns about the ability of governments to effectively address the rise in social needs, and about the most suitable timing and composition of consolidation efforts on the tax and the spending sides.

Figure A2.2. Rising social needs and declining fiscal space

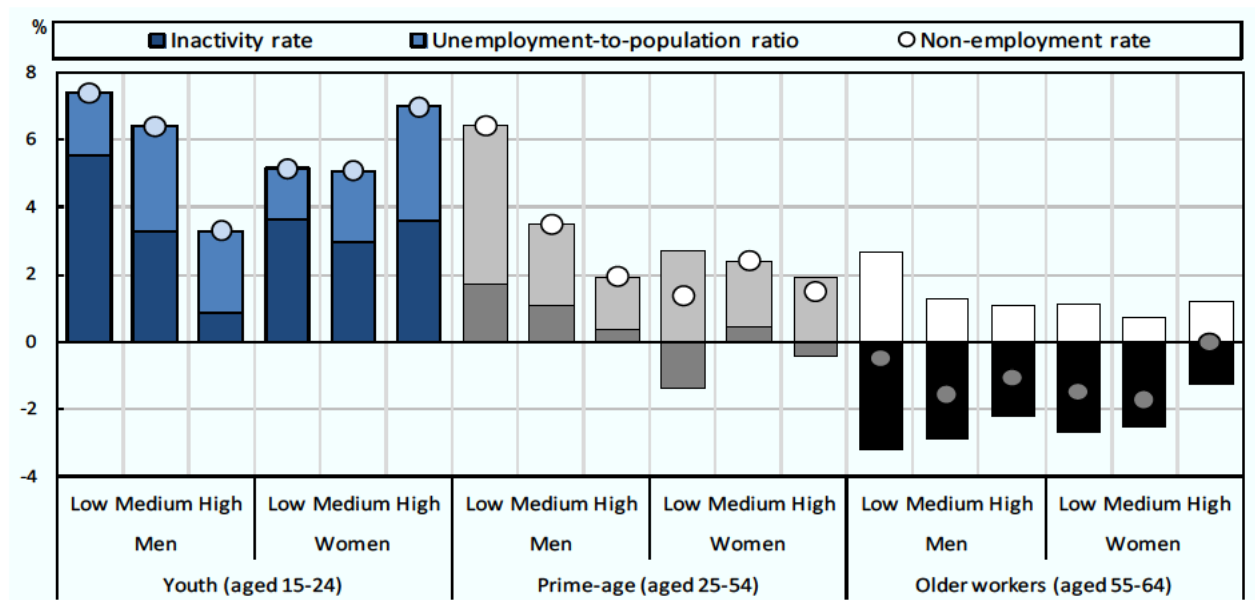


Source: OECD Economic Outlook 92 database (www.oecd.org/economy/outlook/economicoutlook.htm).

113. Since 2007 non-employment rates have increased most strongly among youth, men and low-skilled workers, while women and older workers were more protected. For young people and male workers, this reflects a combination of increased unemployment and reduced labour force participation (Figure A2.3). In addition, low-skilled prime-age workers were most strongly hit by joblessness, including through long-term unemployment. Women and older workers fared somewhat better, as their labour market participation was increasing prior to the crisis and this trend continued. These groups were also hit less by unemployment. Women typically work in sectors less affected by the crisis (public sector and services) compared with men (manufacturing, construction), and many inactive women returned to, or entered, work to compensate for the loss of household income; this is commonly referred to as the “added worker” effect.

Figure A2.3. Employment perspectives of youth and low-skilled deteriorated strongly during the crisis

Percentage-points change of the number of persons in different labour market statuses as a share of population of the indicated group, OECD average^a 2007 Q3-2012 Q3



Note: a) OECD is the weighted average of 21 countries: Austria, Belgium, Canada, the Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, the Netherlands, Norway, Poland, Portugal, Slovenia, Spain, Sweden and Turkey.

Source: OECD (2013, *forthcoming*), Employment Outlook (www.oecd.org/employment/outlook)

114. **The collapse in employment opportunities for youth is of particular concern because of its potential scarring effects.** Unemployment and other labour market difficulties encountered early in the working life can jeopardise long-term career paths and future earnings prospects. The share of youth not in employment, education or training (the so-called “NEETs”) increased in the OECD area since the start of the crisis to 16.4% in the first quarter of 2011 (with pronounced rises in Ireland, Italy and Spain) reflecting mainly rising unemployment of youth outside the education system. For the OECD area as a whole, the number of unemployed youth increased by about 2 million. This is mostly due to a deterioration of the situation of young men: the number of young male NEETs who are unemployed increased by 40% between 2007 and 2011 in the OECD. There is evidence that the effects of unemployment in the first years following entry in the job market can be large and lasting, particularly for the most disadvantaged youth.¹

Income difficulties are increasingly being felt particularly at the lower end of the income distribution and amongst youth

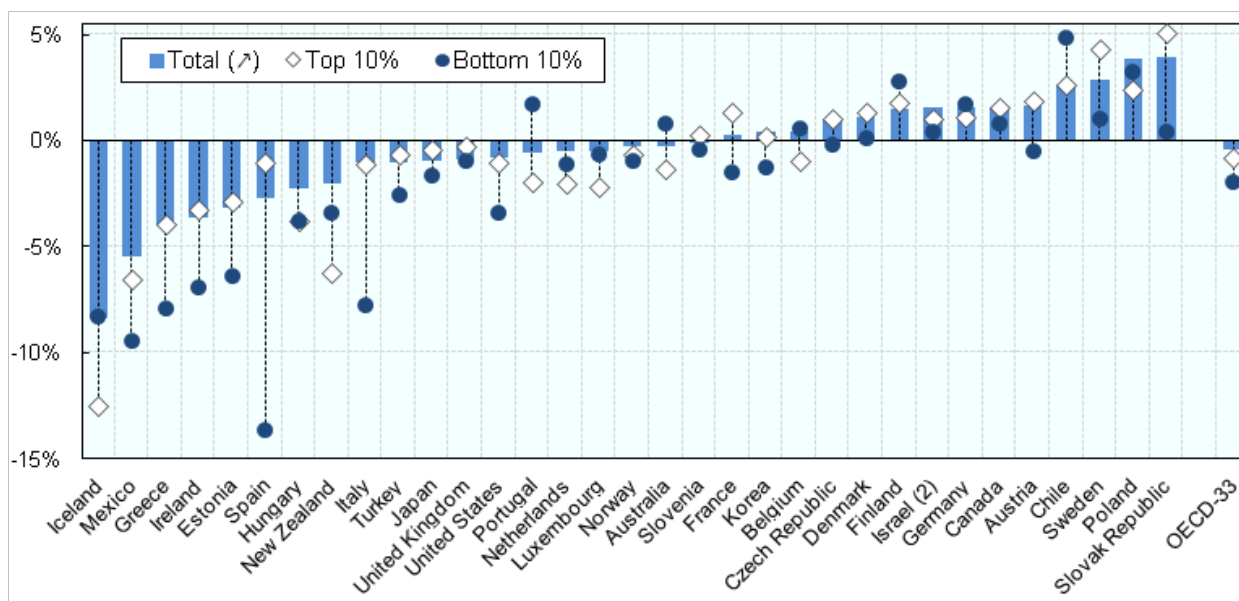
115. **Inevitably, the social impact of the crisis is reflected an increase in the number of people struggling to meet basic needs.** In 2012, one in four people reported income difficulties (based on Gallup surveys), and this proportion was three in four in Hungary and Greece and about one in two in the United States. The share has been on the rise since 2007 in 26 countries, even where social safety nets played an important role in cushioning the crisis (Northern Europe, France, and Germany).

¹ See OECD (2010a) and Scarpetta and Sonnet (2012).

116. Objective measures of household income show that these subjectively-reported difficulties are real but that the burden is not shared evenly. At the beginning of the crisis, falls in capital income affected top incomes and stimulus packages helped cushion falls among those at the lower end of the income distribution. As the crisis continued, however, lower income households lost more from recession or benefited less from the sluggish economic recovery in most countries and especially in those in hard-hit by the crisis, such as Estonia, Greece, Ireland, Italy, and Spain (Figure A2.4). Among the hard-hit countries, Iceland was an exception, with richer households bearing more losses than poorer ones. On average across the OECD as a whole, the incomes of the total population have stagnated between 2007 and 2010, while the incomes of the bottom 10% have fallen at a rate of 2% per year, adding to the long-term trend of rising income inequality.

Figure A2.4. Lower income households tended to lose more or gain less in recent years

Annual percentage changes in disposable income¹ for total population and bottom and top deciles, 2007-2010



Note: Data refer to 2010 except for Chile, Hungary, Japan, New Zealand and Turkey where they refer to 2009 and Ireland and Switzerland where they refer to 2008.

1. Indicators are based on equivalised household incomes.

2. Information on data for Israel: <http://dx.doi.org/10.1787/888932315602>.

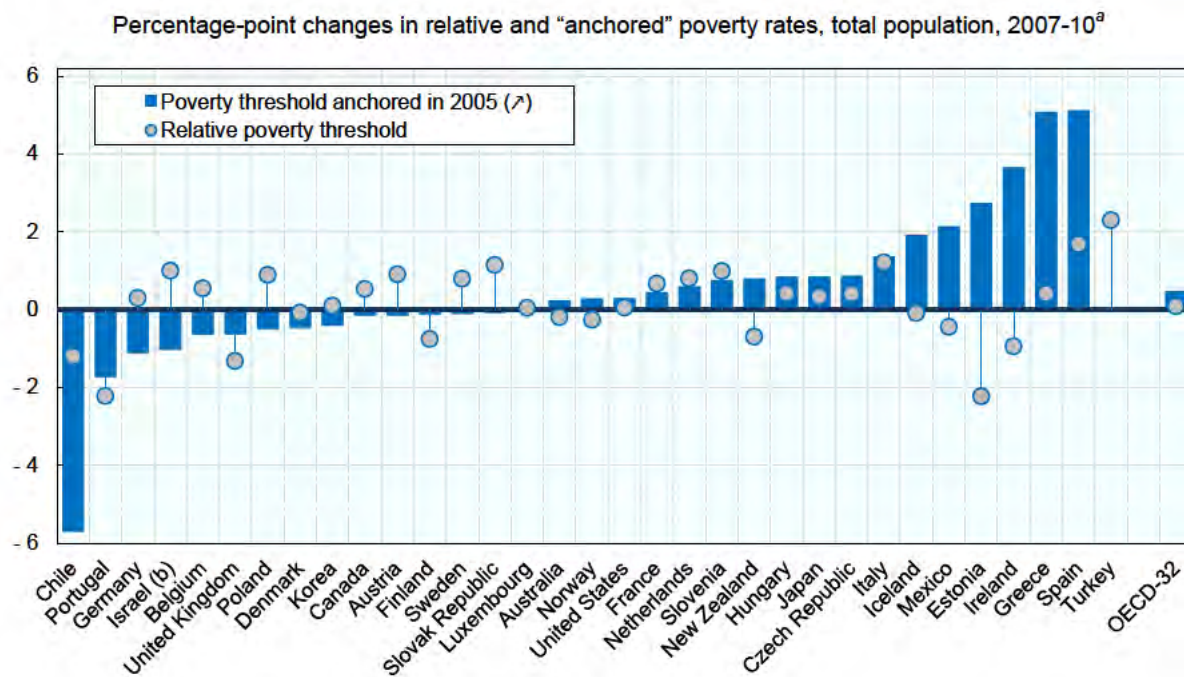
Source: OECD Income Distribution and Poverty Database (www.oecd.org/social/income-distribution-database.htm).

117. The crisis has also contributed to the long-term rise in the risk of poverty observed in some OECD countries during past decades. Based on relative income poverty², the share of the poor has grown by only 0.1 percentage points to 12% in the 24 OECD countries presented in Figure 5. Although increases were much higher, between 1 to 2 percentage points, in Turkey, Spain, Italy and the Slovak Republic, relative poverty diminished in Portugal, and the United Kingdom, notably because benefits (including social assistance in the case of Portugal) cushioned the impact of crisis, at least until 2010. But the commonly used measures of poverty based on current median income are difficult to interpret during recessions (relative poverty might not increase if median income falls significantly). Using a definition of poverty where the median income is “anchored” in a given year (2005) shows much higher increases in poverty, by 2 percentage points or more in some countries, especially Ireland, Greece and Spain (Figure A2.5). Rising poverty was only partly counterbalanced by public policies. Given the depth of the crisis

² Relative income poverty is the share of people with income below half of the national median.

and the implementation of fiscal consolidation programmes, the tax and transfer systems in most countries were unable to hold back the rising tide in market income inequality (notably in Greece, Iceland, Ireland, Mexico, Spain and Turkey).

Figure A2.5. The risk of poverty increased in many countries



Notes: Changes in income poverty using relative and anchored poverty line are based on 50% of current and 2005 median income in each country, respectively. There is no estimate on anchored poverty for Turkey.

a) Data refer to 2006 for Chile and Japan; 2008 for Australia, Finland, France, Germany, Israel, Italy, Mexico, New Zealand, Norway, Sweden and the United States. Last year of reference refers to 2009 for Hungary, Ireland, Japan, New Zealand and Turkey; 2011 for Chile. Data based on EU-SILC for 2010 are still provisional for Austria, Belgium, Czech Republic, Estonia, Finland, Greece, Iceland, Italy, Luxembourg, Poland, Portugal, Spain, Slovak Republic and Slovenia.

b) Information on data for Israel: <http://dx.doi.org/10.1787/888932315602>

Source: OECD Income distribution and Poverty Database (www.oecd.org/social/income-distribution-database.htm).

118. **These poverty trends were not evenly shared across groups.** In most OECD countries, young adults and families with children face considerably higher risks of poverty today than in 2007. According to data from the OECD Income Distribution Database, the share of 18-25 year-olds in households with income less than half the median has increased in 19 OECD countries since 2007, notably in Estonia, Spain and Turkey (by 5 percentage points), but also in the UK (by 4 percentage points), the Netherlands and Ireland (by 3 percentage points). Older people, however, were relatively immune to the rise in poverty which reflects the fact that pensions were largely stable. Out of 30 OECD countries, elderly poverty increased only in 5, and, on average, is now lower than for young adults and children.

Health outcomes might have also deteriorated

119. The social impact of the crisis may have altered health outcomes, but there remains considerable uncertainty about the short and long-term effects. An economic downturn may result in different responses among individuals making it difficult to estimate its final impact. For example, some people may reduce their spending on alcohol after a fall in income, but for others the prospect of unemployment may fuel greater alcohol dependence. In addition, unemployment might increase the risk of depression, anxiety, substance abuse, and antisocial behaviour (Catalano, 2009).

120. **However, the economic crisis may also have led to greater unmet health care needs, notably among the poorest.** With costs becoming a greater issue during the economic crisis, families have reduced their health care consumption, particularly in countries with high co-payments.³ This includes not only routine medical care but also preventive measures such as breast cancer screening, with one study showing that following bad economic times the incidence of diagnosing advanced disease becomes relatively more common compared to finding local disease (Catalano, 2003). Studies such as these suggest that while people may be delaying their routine health checks in the short-term, these may have long-term implications on health outcomes. Poorer individuals, who are also likely to have higher health care needs may be of even greater risk of declining health during periods of rising unemployment notably because they avoid health care costs (Edwards, 2008; Schoen *et al*, 2011).

The trend of rising fertility has stalled in several countries

121. There is also evidence that the recent trend of rising fertility observed in several OECD countries before the crisis has once again come to a halt. While fertility rates in OECD countries declined dramatically between the 1970s and early 2000s, one encouraging recent development was that of a modest recovery in total fertility rates since the mid-2000s, which resulted in the OECD's fertility rate to average 1.75 in 2008. However, income difficulties can lead families to forgo their birth plans and this may help explain the recent falls in a number of countries (two decimal points in the United States and Iceland between 2009 and 2011, one decimal point in Denmark, Estonia, Greece, Hungary, Luxembourg, Norway, Poland, and Spain). Even very small variations of fertility rates will have a long-term impact on demographics, on patterns of population ageing, and on the sustainability of existing social and health provisions.

As a result, where the crisis hit strongly, life satisfaction is now lower than it was in 2007

122. **For the OECD taken as a whole, life satisfaction has been fairly stable since 2007.** Based on estimates from the Gallup World Poll, in the OECD as a whole, life satisfaction has been stable since 2007. But there are considerable differences across countries, which are strongly correlated to the increase in

³ See Lusardi, 2010. A survey of eleven OECD countries shows that, on average, around 15% of respondents said that health costs stopped them from visiting their doctor, filling a script and/or undertaking a medical test at least once during the last 12 months (Schoen *et al*, 2010).

unemployment over the same period. Life satisfaction deteriorated most in Greece, Italy and Spain, while it improved in a few countries where the impact of the economic crisis was either less severe or less long-lasting (*e.g.* Mexico, Sweden and Germany).

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

123. The major emerging economies have made very significant progress in reducing absolute poverty, but high inequality and the comparatively low capacity of social protection systems remain important challenges. In the major emerging economies, the impact of the global downturn on economic activity and thus on social outcomes tended to be less severe than in most of the OECD area. The context in which it took place also differed significantly. Longer periods of strong economic growth have helped to reduce extreme absolute poverty in emerging economies. However, experiences of earlier recessions in these countries show that developing sustainable and “crisis-proof” social protection systems is crucial nonetheless. Inequality and poverty continue to be major policy challenges in emerging economies, and social budgets are comparatively much smaller than in the OECD area.

II. HOW DID GOVERNMENTS RESPOND TO THE CRISIS IN TERMS OF SOCIAL POLICY DESIGN?

Social spending has increased substantially in real terms since 2007

124. **The global economic crisis has led to a sustained increase in social spending both as a share of GDP and in real terms.** On average across the OECD countries, public social spending-to-GDP ratios increased from around 19% in 2007 to 22% of GDP in 2009/11 and estimates for 2012 suggest it has remained high since. The sharp decline in GDP in some countries can explain part of this increase, but social spending in real terms has also increased across the OECD area, except in Greece Hungary and Portugal (Figure A2.6).

Figure A2.6. Real social spending increased until 2010 and then stabilised

Panel A – Public social spending and GDP, 2007 to 2011, OECD average, base 100 in 2007

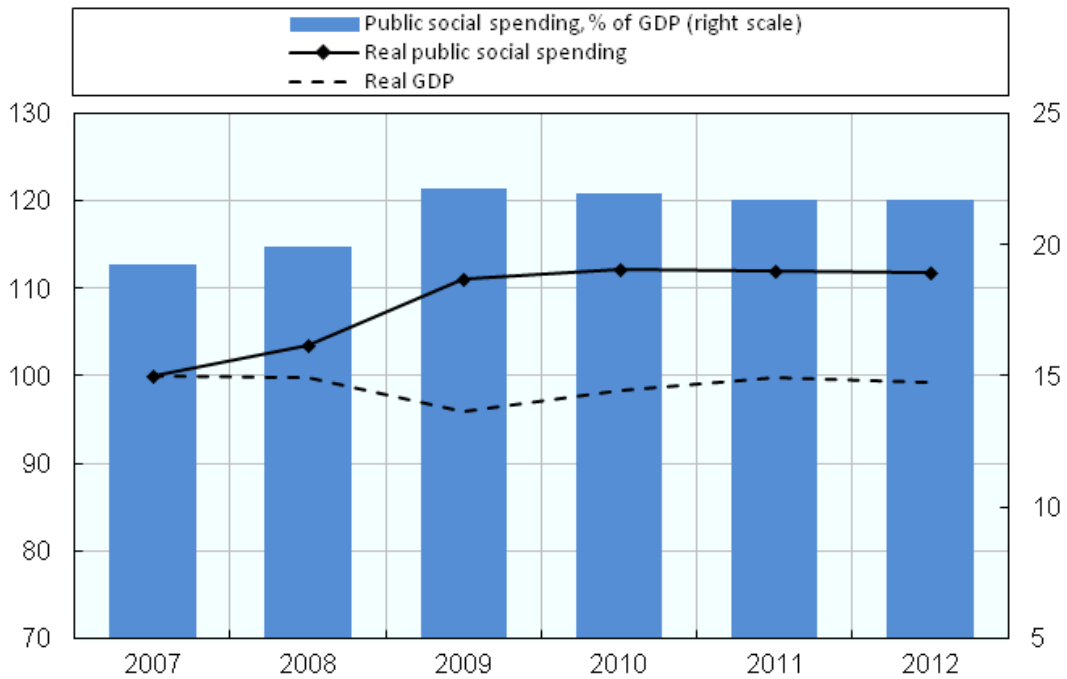


Table A2.1. Social spending increased less in countries that were more heavily affected by the crisis

| | | Change in real PUBLIC SOCIAL SPENDING | | | | |
|--------------------|---------------------------------------|---------------------------------------|--|--|-------------------------------------|--------------------------------|
| | | below-average (below 6%) | around-average (between 6% and 14%) | above-average (above 14%) | | |
| Change in real GDP | above-average (above 3.5%) | - | Canada Mexico | Poland Sweden | Australia Chile Israel | Korea Norway Switzerland |
| | around-average (between -5% and 3.5%) | Germany | Austria Belgium Denmark Finland | France Luxembourg Netherlands Slovak Republic | New Zealand United States | |
| | below-average (below -5%) | Greece Hungary Iceland | Italy Portugal | Czech Republic Ireland | Spain Slovenia United Kingdom | Estonia |

Note : (1) Public social spending totals reflect detailed social expenditure programme data for 2007-2009. Consistent with these historical series, total public social expenditure was calculated for 2010 and 2011, and estimated for 2012, on the basis of national sources for non-European OECD countries, and/or OECD (2012b), the May 2012 edition of the OECD Economic Outlook and EC DG ECFIN (2012), the European Union's Annual Macro-economic database (AMECO) as at May 2012. (2) Countries are grouped "above", "average" and "below" in line with the changes to real social spending and real GDP between the average for 2007 and 2008 and the average for 2011 and 2012. The average change in real social spending between 2007-08 and 2011-12 was +9.9% with a standard deviation of 8.5%. The average change in real GDP over the same period was -0.7% with a standard deviation of 8.5%. The OECD average is calculated as the un-weighted average for 32 OECD countries for which data are available (Japan and Turkey are not included). With around 30 countries in the sample, an observation is statistically significantly different from the average if it is at least half a standard deviation above or below the average change. In case of social spending trends the interval of around average growth from 2007/08 to 2011/12 is 6% to 14%; for GDP growth from -5% to 3.5%.

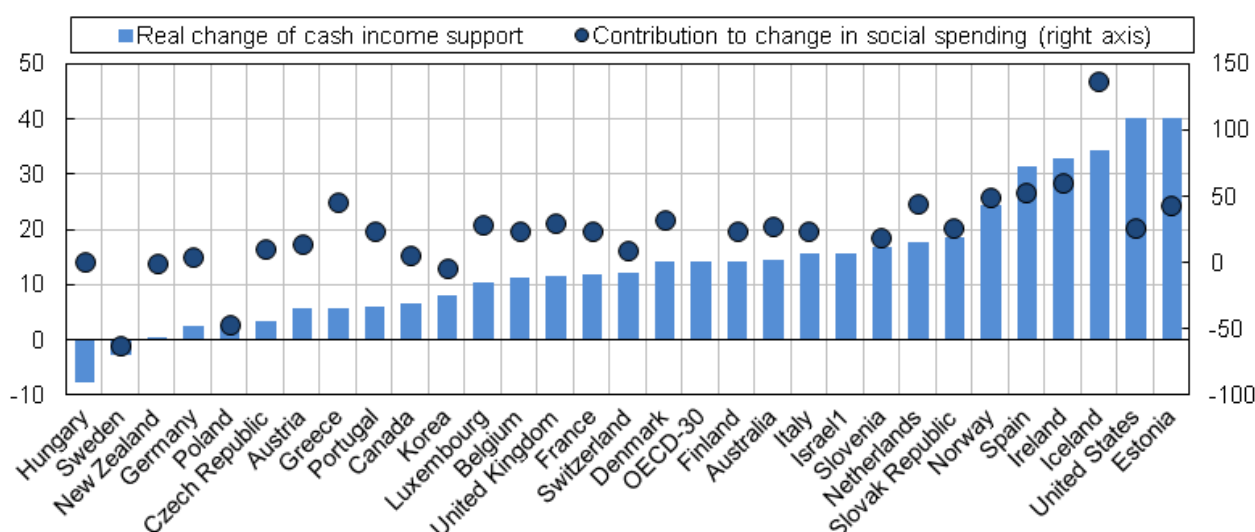
Source: OECD (2012), OECD Social Expenditure database via www.oecd.org/els/social/expenditure.

Transfers to the working-age population were driving the increases in overall social expenditure

126. **The labour market crisis led primarily to a steep increase in social spending for working-age individuals** (unemployment benefits, general social assistance, disability benefits and cash family benefits, see Figure A2.7). On average across the OECD, spending on these “working-age transfers” rose by 14% accounting for 30% of the total increase in social spending (Figure A2.7), even though these benefits make up only 20% of total public social spending, on average.

Figure A2.7. Spending on “working-age” cash transfers rose steeply

Percentage change and contribution to change in total social spending, 2007/08 - 2011/12



Notes: “Working age” cash transfers refers to spending on the following SOCX categories: Incapacity benefits (disability and sickness), Family cash benefits, Unemployment and so-called “Other Social Policy Areas” (which includes minimum-income). The contribution of changes in “working-age” transfers to the change in total social spending is calculated using spending as a percentage of GDP (right axis). As shown in Figure 6, GDP fell more strongly than real spending in some countries (e.g., Greece)
1. Information on data for Israel: <http://dx.doi.org/10.1787/888932315602>.

Source: Public social spending totals reflect detailed social expenditure programme data for 1980-2009; national aggregated for 2010-2011 and estimates for 2012, as based on national aggregates in national sources, and/or the OECD Economic Outlook, No 91, May 2012, and the European Union’s Annual Macro-economic database (AMECO), as at May 2012. For detail on the underlying methodology regarding estimates for recent years, and the detailed social expenditure programme data, see Adema, et al. (2011).

127. In the early phase of the crisis, much of the increase in social spending was due to a greater need for out-of-work benefits, especially unemployment insurance. With the rapid increase in unemployment in many countries, spending on unemployment insurance benefits increased swiftly everywhere. During the early stages of the crisis, several countries also boosted spending on “partial” unemployment benefits or “short-term working schemes” (Hijzen and Venn, 2010). These programmes, which provide income support to those affected by temporary reductions of working hours and earnings, can be effective at reducing or slowing the number of initial job losses, and at spreading the economic burden of a temporary downturn more evenly across income groups (Bargain *et al.*, 2011; Hijzen and Martin, 2012). As the crisis progressed, especially in countries with persistently high unemployment and relatively short duration of unemployment insurance benefits, spending on the second tier unemployment assistance benefits started rising as well. Overall unemployment compensation increased from an average of 0.7% of GDP in 2007 to 1.1% in 2009, which corresponds to an increase of spending of about 80% in real terms. Spending on unemployment benefits rose most steeply in Estonia, Iceland and the United States, where the increase exceeded 200%. Spending more than doubled in Turkey, Ireland, Japan, United Kingdom and New Zealand.

128. Nonetheless, for the majority of OECD countries, there was very little change overall in the generosity of benefits for the jobless between 2007 and 2011. Figure A2.8 shows the Net Replacement Rate (NRR, i.e. the ratio of income received while not working to that received in work) for a single individual over a 5 year unemployment spell.⁴ In about half of the countries, the NRR changed by less than 5 percent and, in another 5 by less than 10 percent. In a few countries, higher benefits and/or longer durations resulted in much larger NRR increases (especially the United States but also Greece, Canada, Italy).⁵ In Norway and Denmark the lower NRR resulted from a shortening of maximum benefit durations (before the crisis in Norway, and in 2010 in Denmark).⁶

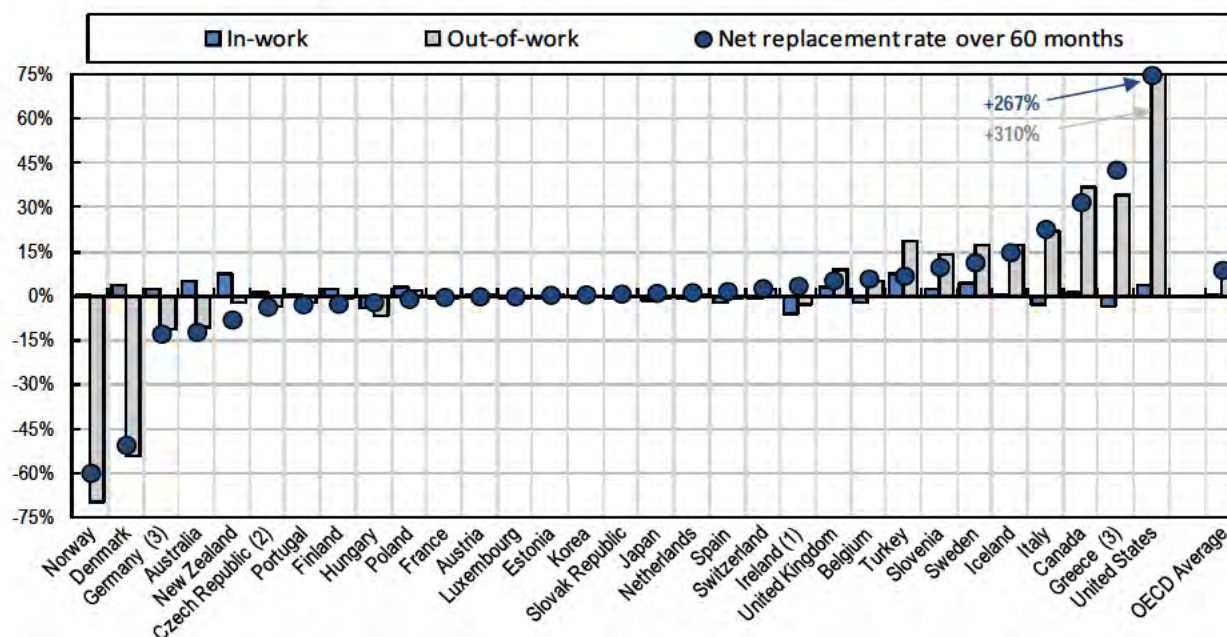
⁴ This synthetic indicator takes into account unemployment assistance and in some cases also minimum income schemes which take over after unemployment benefits are exhausted. By showing the replacement rate averaged over a long unemployment spell, the indicator captures changes in both benefit levels and duration.

⁵ In the case of the United States, the very large increase in NRRs was driven by the temporary extensions of unemployment benefit durations to 99 weeks (from the standard 26 weeks). This was mostly a result of discretionary legislation but also reflected automatic extensions that are triggered once unemployment in a State exceeds a specific threshold. The changes came into force progressively from 2008, and were still in place in 2011. At the opposite end, an erosion of assistance benefit levels relative to wage growth explains most of the fall in Germany, Australia and New Zealand. In Germany, the end of the transitional benefit, which had eased income losses when moving from insurance to assistance benefits, further reduced the NRR.

⁶ In Norway the termination of the “Waiting Benefit” in 2008 reduced from the maximum duration from 5 years to 2 and in 2010 Denmark reduced the maximum duration over which unemployment insurance benefits were available from 4 to 2 years.

Figure A2.8. The generosity of unemployment benefits changed little between 2007 and 2011

Percentage change in the “Over 5 years Net Replacement Rate” for a low-earning single individual, 2007-2011



Notes: Calculations refer to a single individual with previous earnings equal to 67% of the average wage.

1. In Ireland, both in-work income and out-of-work benefits fell. The fall in in-work income was stronger, causing the NRR to increase.
2. The Czech Republic, increasing in-work incomes and lower out-of-work benefits rein (increase) appears to play a stronger role than the out-of-work income (decrease) in reducing the NRR - though these changes reinforce each other.
3. The only countries with relatively large NRR changes between 2010 and 2011 were Germany (reduced generosity due to the termination of a transition payment for those moving from insurance to assistance benefits) and Greece (higher NRR due to a combination of increased nominal benefit value and wage deflation).

Source: OECD Tax-Benefit models (www.oecd.org/els/social/workincentives).

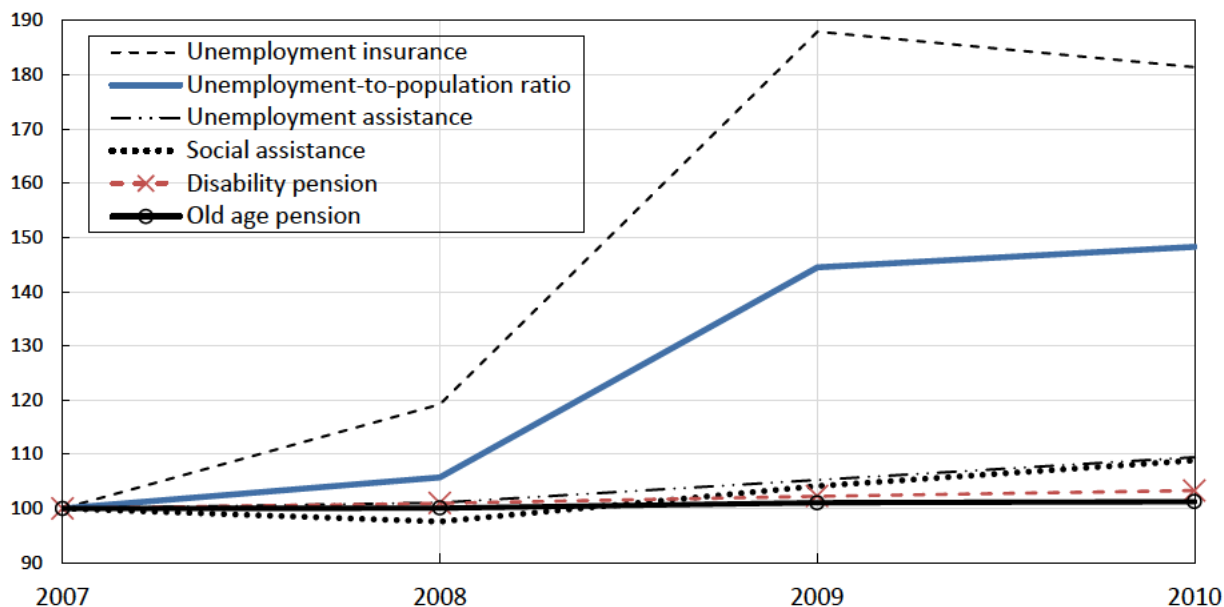
129. **In countries where family support is largely income-tested, public spending on family cash benefits increased.** The OECD average increase of family benefits between 2007 and 2009 was 0.3 percentage points of GDP, which corresponds to a 10% increase in real terms. Real spending in this category increased by 50% in Korea, 30% in Greece, 20% in Ireland and Portugal and 10% in the United Kingdom. In addition, tax credits are likely to have increased as well, even though data is not available for all countries on a comparative basis. In the United Kingdom, for example, the rise in the number of low-income families increased both the take-up of the Child Tax Credit and the Working Tax Credit, and the number of claimants with maximum payments, helping to cushion the effect of the crisis for poorer families.

130. **In sharp contrast with previous recessions, neither old-age pensions nor disability benefit receipt increased significantly** (Figure A2.9). In previous downturns, early retirement and disability programmes were frequently used to ease the pressure in the labour market, resulting in large and practically irreversible increases in social expenditures. This has not occurred in the recent crisis. The take-up of old-age and disability benefits continued to be driven primarily by long-term demographic factors. In the case of disability programmes, preliminary evidence suggests that structural reforms – which aimed at strengthening gate-keeping, the assessment of health conditions, and the incentives to return to work – have made these programmes more resilient to the economic cycle (see below). Pension spending reflects long-term financial commitments and entitlements, as well as demographic trends, and tends to be much

less sensitive to the business cycle, especially since many countries have been closing access to early retirement. At the same time, fiscal consolidation plans have, up until now, focussed largely on benefits for the working-age population, while largely protecting pension spending.

Figure A2.9. Participants in social programmes during the crisis, except for old-age and disability benefits, OECD total

For the unemployment share: ratio of unemployment to working-age population; for the programme participation rates: ratio of participants to the working-age population, or total population for old-age. Base 100 in 2007.



Notes: All trajectories are computed considering a base of 100 in the first quarter of 2007. Some few missing quarters were interpolated.

Source: Calculations based on OECD (2013, forthcoming) Social Benefits Recipients Database.

131. Contrary to the evolution of spending on social transfers, the rise in health spending has stalled since 2008 in many OECD countries, after long periods of rapid growth. Good quality health care is not only crucial for individual well-being, but also for maintaining the work capacity and productivity of groups affected by the economic downturn. In the fifteen years prior to the financial and economic crisis, health spending grew three times as fast as GDP per capita in the OECD area. In 2010, health spending growth as a percentage of GDP was nil on average and almost all OECD countries recorded a slowdown in health expenditure growth rates in real terms. Preliminary estimates suggest that the decline continued in 2011. Since, on average across the OECD, public financing accounts for around three quarters of overall health spending, much of the overall drop can be attributed to the decrease in public expenditure on health. While the overall level of government health spending tended to remain largely unchanged in the immediate wake of the economic slowdown - even in some of the hardest-hit countries - cuts in public spending really began to take more widespread effect in 2010. For the countries with big expenditure reductions, or a significant slowdown in expenditure growth (notably Ireland, Iceland, Estonia, Greece), a reversal of pre-crisis trends was seen in all three main spending areas - inpatient, outpatient and pharmaceuticals.

132. The major emerging economies continue to address concerns over poverty and inequality by strengthening redistribution, and support for the poor. Strong economic growth has helped to reduce extreme and absolute poverty and this trend has largely continued since 2007. Achievements cannot be explained by aggregate growth alone, however. They also reflect effective redistribution policies, and

there are examples of well-designed targeted programmes that are helping to cushion the impact of economic shocks on the most vulnerable (Box A2.1 below provides further details on recent policy initiatives).

- In **Brazil**, income redistribution is a central pillar of the growth model. The country has made tremendous progress in lifting millions of people out of poverty and reducing inequality since the early 1990s. The *Bolsa Familia* conditional cash transfer has become a prominent model of successful poverty reduction programmes, and a benchmark for anti-poverty measures in other countries.
- In **India**, where fiscal deficits have been much bigger than in other emerging economies, spending on social welfare is relatively high. Spending is skewed towards food and other subsidies and towards employment in public work schemes, while income transfers play a much more limited role. Welfare schemes developed over the past years may, however, have contributed to mitigate the social impact of the crisis.
- High levels of income inequality and poverty in **South Africa** are, in large part, a reflection of inactivity and unemployment. Between 2007 and 2011, labour utilisation deteriorated further. On the contrary, the progressivity of taxes and the expansion of social transfers since the mid-1990s have strengthened government redistribution.
- Inequality is also high in **China**, but stopped rising a few years ago, peaking in 2008. In urban areas, inequality has trended down for some years, reflecting changing wage patterns and larger reimbursements for health care at the lower end of the spectrum. The gap between rural and urban incomes has also declined as migrants transfer income to the countryside. However, in rural areas, migration has widened the gap between families where nobody has migrated and those with migrants, pushing up inequality. Guidelines issued in February 2013 by the State Council encourage further measures to reduce the level of inequality and boost consumption.
- In **Indonesia**, absolute poverty declined rapidly prior to the Asian financial crisis of the late 1990s, and this trend continued thereafter, albeit at a reduced rate. The share of people living below the national poverty line was cut almost in half between 2000 and 2010 (to 13.3%). The pro-poor economic growth was, however, accompanied by a significant rise in income inequality, which also had substantial effects on the lower part of the income distribution. Overall, Indonesia's expenditure on the main poverty reduction programmes remains minor, with approximately 0.5 per cent of GDP spent on social assistance between 2004 until 2010, compared with an average of about 1.5% in developing countries (World Bank, 2012).

Box A2.1 Major emerging economies continue to seek ways to strengthen redistribution

In contrast to recent and projected austerity measures in much of the OECD area, large emerging economies have tended to bolster redistribution measures as they continued addressing concerns over high poverty and inequality. There are major examples of new policy initiatives, as well as measures to increase the effectiveness of existing measures. Challenges remain, however, as income gaps are often very large and the effects of structural changes, such as rural-urban migration, can further aggravate them. Reforms have also run into issues of administrative capacity that can hamper effective implementation of social protection measures, although there are encouraging examples of well designed and highly successful programmes.

In Brazil, the poorest 10 percent of the population enjoyed very fast annual income growth rates (comparable with China's per capita GDP growth rates), while income gains in the top decile were smaller (closer to GDP per capita growth in Germany). Changes in both labour and non-labour incomes have played equally important roles in the sustained inequality reductions. Labour incomes have become more equally distributed because the earnings gaps between high-skilled and low-skilled labour (the "education premium", which have traditionally been very high in Brazil) have narrowed markedly, and because better access to education has allowed more households to earn higher wages. At the same time, government transfers have played a crucial role. The conditional cash transfer programme (Bolsa Familia) provides transfers to low income households, conditional on school attendance and health check-ups. Bolsa Familia has become a benchmark for anti-poverty policies in many other countries. Recent refinements have further increased the generosity, effectively lifting all programme participants' with income below the national poverty line above that threshold.

In India, the expansion of a health insurance system for the poor (RSBY) is an important and welcome development since large out-of-pocket expenses associated with hospital stays have long been a barrier in access for the poor. Moreover, the National Rural Employment Guarantee Scheme (NREGS), rolled out in 2006 and subsequently expanded nationally, is a workfare scheme that provides a guarantee of a minimum of 100 days of employment to rural inhabitants at a minimum wage. It also aims at boosting rural income, stabilising agricultural production and reducing rural-urban migration by funding small-scale farm and infrastructure projects. It thus provides a safety net for the rural poor. However, it does not cover the elderly or children, and there is no national equivalent for urban residents. As in other parts of the developing world, high levels of inflation affecting food items remains a crucial issue in India. Although food inflation traditionally affects the poor most, adverse effects have been mitigated by two factors in India. First, high food prices are partly reflected in higher wages in rural areas. Second, the government has recently made efforts to increase and better target food subsidies.

South Africa has, over recent years, undone about 40% of the increase in market-income inequality by an expansion of social transfers and two thirds of income to the bottom quintile now comes from social assistance. Nevertheless, the reduction of inequality attributable to taxes and transfers remains well below OECD levels. The two main strategic policy documents of the South African government, the National Development Plan and the New Growth Path put much emphasis on measures to increase employment and sharply reduce unemployment. At the same time, limited administrative capacity, especially at the sub-national government level, is one of the constraints to building a more inclusive society. In addition, informational problems arise when engaging households with poor literacy in bureaucratic processes. For instance, the take-up rate for the Child Support Grant (a major social assistance programme) is only 60%.

The China State Council issue guidelines in February 2013 encouraging further measures to reduce the level of inequality and boost consumption. This includes a strengthening of redistribution through better tax collection and pushing ahead with property taxes, as well as an increase in social spending (from 36% in 2011 to 38% by 2015), with an emphasis on lower-income regions via intergovernmental transfers. As in South Africa, effective implementation at a local level is likely to be key in an effective functioning of redistributive policies, especially in big and expanding cities and in the areas around them.

In Indonesia, a new era of decentralisation after the Asian financial crisis in the late 1990s brought significant changes in both the country's political structure and in social policy strategies. While most centrally managed poverty alleviation policies were universal, decentralisation was accompanied by increasingly targeted measures to help the poor. In addition to resource provision through social assistance, 'direct' poverty alleviation strategies, such as improved access to health and education are now much more common. In a culturally, geographically and economically very heterogeneous country, these decentralised intervention strategies have had positive impacts. As in other emerging economies, implementation challenges remain, however, especially in relation to appropriate targeting of beneficiaries. Dealing with inefficiencies and "leakage" in social assistance is one key policy challenge. In Indonesia, expenditure on the main poverty reduction programmes remains small, with approximately 0.5 per cent of GDP spent on social assistance between 2004 until 2010, compared with an average of about 1.5% in developing countries (World Bank, 2012). In part, the low spending levels are due to weak tax revenues; although they have increased in recent years, tax revenues are only 12% of GDP - significantly lower than in other emerging economies.

III. FISCAL MEASURES: EFFECTS ON SOCIAL POLICIES AND SOCIAL OUTCOMES

Social policies are now at the core of fiscal consolidation

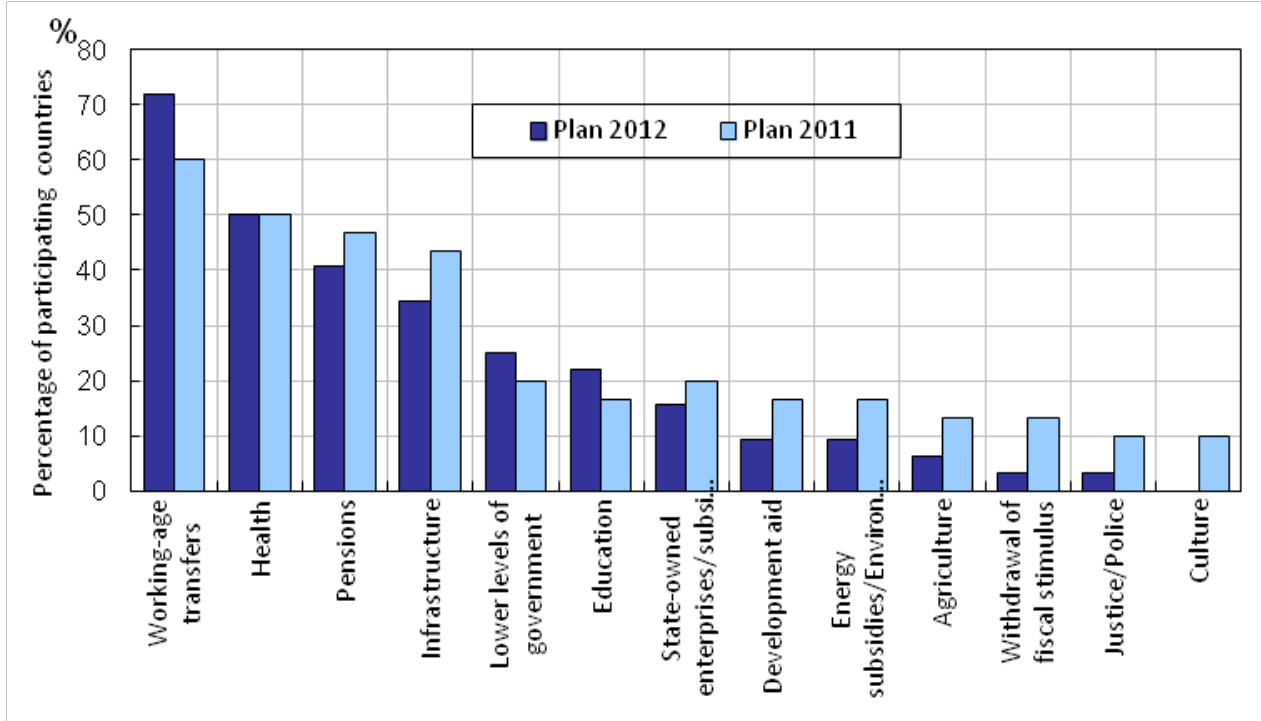
133. **Since 2011, by far the greatest number of consolidation measures among all public spending areas was targeted towards spending on social transfers.** Based on data collected through OECD questionnaires sent out in 2011 and 2012 on financial plans (OECD, 2012), the consolidation plans of many countries include unspecified savings, *i.e.* no details were available concerning savings measures in the form of general spending cuts across departments. Nevertheless, that the most frequently targeted area for savings is “working-age transfers” (unemployment, social assistance, disability and family benefits), followed by health care and old-age pensions (Figure A2.10). Only a few countries did not report any consolidation plan in working-age transfer programmes in 2012 (Estonia, Switzerland), health (Estonia, Italy), or pensions (Estonia).

134. **More than two-thirds of OECD countries reported plans to reduce spending on “working-age transfers” in 2012.** Greece planned to reduce such working-age transfers by 1.9% of GDP with reductions in social security funds and social spending; this percentage is the highest among OECD countries. Ireland, Hungary, Poland, and Germany and the United Kingdom planned reductions in the area of transfers for non-elderly people in excess of 1% of GDP. The United Kingdom stepped up planned expenditure reductions from 0.4% of GDP in 2011 to 1.1% in 2012 through reductions in child and disability benefits. In France, Iceland and the Netherlands savings plans in this area summed to more than 0.6% of GDP in 2012.

135. **Health is the second most frequently mentioned area of fiscal savings, with about half of the countries reporting reductions in spending.** These measures constitute a major share of expenditure savings in all countries with an IMF/EU programme: Greece, Ireland and Portugal. For example, Portugal plans to reduce expenditure in the health system, especially in the areas of pharmaceuticals, user fees, public health systems and through hospital restructuring. The savings on health expenditures are expected to amount to as much as 1% of GDP in Ireland and Portugal. Belgium and Spain also substantially increased their savings target in the health area, up to 1% and 0.7% of GDP respectively.

Figure A2.10. Social transfers are more often included in fiscal consolidation plans than other areas of public spending

Major programme measures in fiscal consolidation plans, by domain



Source: OECD Restoring Public Finances, 2012 Update, Survey). Sources: OECD Fiscal Consolidation Survey 2012, and OECD (2011), "Restoring Public Finances: Fiscal Consolidation in OECD Countries". Note: A questionnaire was submitted to countries in December 2011 to update The OECD 2010-11 report on fiscal consolidation strategies. Based on country responses and publicly available sources, information was collected for 31 countries. Explanation: 70% of countries plan to cut welfare spending in 2012. Welfare includes working-age social transfers, such as unemployment benefits, social assistance, disability benefits, child benefits, etc. Pensions comprise old-age pensions.

These projections are confirmed by recent policy developments

136. **Most recently, some countries have started to reduce the coverage or the generosity of income support to the working-age population (Tables A2.2 and A2.3).** This concerned mainly unemployment insurance programmes, but also family and child support, while assistance programmes often remained unaffected.

- **Some temporary measures to extend the duration or coverage of unemployment insurance programmes are being phased out.** In some countries, temporary unemployment benefit measures taken in 2009/2010 were not renewed (*e.g.* Greece), or extensions of benefit duration are now being reversed (*e.g.*, Canada and Spain; in the United States, several States have begun cutting back benefit durations meaning that effective durations are shorter even while federal extensions remain in place). A few other countries reduced the maximum duration of insurance programmes (Denmark, Hungary) or tightened eligibility conditions (Czech Republic) in order to strengthen incentives to resume work while supporting fiscal consolidation plans.

- **In parallel, the generosity of unemployment assistance programmes has been increased in some countries in the face of rising risks of long-term unemployment.** In Finland, the basic allowance was increased in 2012. In Austria, the benefits for the unemployed involved in training programmes are being enhanced in 2013. In the Netherlands, a temporary assistance benefit for older unemployed was introduced in 2010 (to expire in 2016). The same type of programmes has been extended in France during the crisis. Only in a few cases was support for longer-term unemployed made less generous (*e.g.* in Germany, although this concerned only people moving from insurance to assistance benefits).
- **General social assistance programmes, such as minimum income schemes, were often left unchanged or were enhanced.** In some countries, benefit levels were increased (in the United States for the Supplemental Nutrition Assistance Program since 2009, in the Czech Republic and in Estonia since 2011, in Finland since 2012, and in France in 2013). However, in a few cases, these benefits of “last-resort” were made less generous (Portugal and Hungary reduced benefit levels in 2011; Hungary also tightened eligibility conditions).
- **Since 2010, fiscal consolidation measures have also been targeting child or family allowances.** In the early phase of the crisis, child or family allowances (including tax allowances) were increased in a number of countries on a temporary basis, but often family support had already been extended in the previous years (Table A2.3). For instance in France income taxes for low income families were reduced, while in several other countries (Germany, Italy, Hungary) one-off benefits were paid to families in need. A few countries (*e.g.* Italy and Poland) also created additional housing benefits. But since 2010, more consolidation measures have been put in place, and some of the cuts included parental leave policies, as well as temporary postponements or reductions in payments. A number of countries froze benefits and/or tightened eligibility conditions (*e.g.* Greece, Hungary, Netherlands and the United Kingdom). Some froze or reduced birth-related benefits (Czech Republic, Estonia). Reduction in housing support was less frequent.
- **Some countries continued to push structural reforms of disability programmes by introducing stronger gate-keeping mechanisms, time-limiting benefits and reassessing benefit caseloads.** These policies aim to limit the number of people moving on to long-term disability benefits and curb the associated high expenditures. They minimise the risk that workers experiencing long-term unemployment during the crisis drift onto disability benefit schemes from which it is very difficult to exit even when labour market conditions improve. Such reforms were implemented in Sweden, Netherlands, Switzerland and the United Kingdom, and have enabled countries to stay on track with a trend decline in disability benefit claims. By contrast, some of the countries that have seen large increases in unemployment and did not implement disability reforms are now facing a significant increase in the beneficiary rate *e.g.* more than 10% in Estonia and the United States (OECD Social Benefit Reciprocity Database, forthcoming). However, without appropriate employment support, a combination of comprehensive reassessment of health conditions and tighter eligibility criteria also runs the risk of increasing of poverty by excluding vulnerable people from the income transfers altogether.

Table A2.2. Changes in unemployment, general social assistance, and disability benefits, selected countries, 2009-2012

| Country | Year | Eligibility | Benefit level / duration | Programme phased in (+) / out (-) | Reform | Description |
|----------------------------------|-----------|-------------|--------------------------|-----------------------------------|--------|---|
| <i>Guaranteed minimum income</i> | | | | | | |
| Austria | 2011 | | + | | | National harmonisation of minimum guaranteed income |
| Czech Republic | 2012 | | + | | | Adjustment of living and subsistence minimum |
| Estonia | 2011 | | + | | | Increase in nominal base to calculate guaranteed minimum income |
| Hungary | 2010-12 | - | - | | | Restricted eligibility and reduced benefit levels |
| Portugal | 2011-12 | - | - | | | Reduced benefit level for specific family members |
| United States | 2009 | | + | | | Increased maximum SNAP allotments |
| <i>Unemployment benefits</i> | | | | | | |
| Austria | 2013 | + | - | | | Additional supplement for UB recipients participating in PES training |
| Australia | 2012 | | | | | Wage subsidy to encourage employers to take on eligible people who have been unemployed for at least two years |
| Canada | 2010 | | + | | | Extended duration of UI |
| Czech Republic | 2011-12 | - | - | | | Tighter contribution requirements and reduced benefit levels |
| Denmark | 2010 | | - | | | Reduced duration of UI |
| Finland | 2010 | | + | | | Extension of higher initial benefit rate |
| | 2009 | + | | - | | Increased Basic Allowance |
| France | 2009-2010 | + | + | -/+ | | Reduced contribution requirements for UI; slightly longer UI benefit duration; one-off payment for jobseekers not entitled to UI (introduced 2009) phased out. |
| Germany | 2009-2012 | | - | | | Termination of transitional UBII in 2011 (a payment that had reduced the benefit loss for someone transitioning from UI to UA). The real value of UBII levels themselves has changed little since 2009. |
| Greece | 2010 | | | -/+ | | UA (introduced in 2009) abolished |
| Hungary | 2011 | | - | | | Maximum duration of UI benefits reduced |
| Japan | 2011-12 | + | + | | | Extended duration of UI |
| Netherlands | 2010 | | | + | | Temporary UA for older workers |
| Poland | 2010 | | + | | | Increased benefit over first 3 months |
| Portugal | 2010-12 | + | +/- | + | | UI benefit payment rate increased, but duration was subsequently shortened, benefit ceiling reduced, and additional reduction introduced after 6 months of receipt. UA benefits increased and made more inclusive in 2012. Creation of an unemployment benefit to some self-employed. |
| Spain | 2009 | | | + | | Introduction of temporary lump-sum payment for participants in labour-market insertion activities |
| | 2011-12 | | - | | | UI replacement rate lower after 6 months; temporary lump-sum payment for participants in labour-market activities reduced. |
| Slovenia | 2011 | | + | | | Increased benefit over first 3 months |
| United States | 2008-11 | | + | | | Discretionary and automatic extensions of UI benefit duration (state and federal). |
| | 2012 | | | - | | Beginning reversal of state-level extensions. |
| <i>Disability benefits</i> | | | | | | |
| Austria | 2013 | - | | | | Access to pensions tightened for white-collar employees and skilled workers |
| Australia | 2012 | | - | | | Strengthen the gateway to Disability Pensions. |
| | 2011-12 | + | | | | Amended the List of Recognised Disabilities. Eligibility criteria to Carer benefits become more inclusive. |
| Czech Republic | 2012 | | | | | Several (10) former benefits for disabled are merged in 2 new benefits |
| Finland | 2012 | | - | | | Changes in reimbursements for pharmaceutical expenses |
| Greece | 2012 | - | | | | Improve and simplify eligibility rules to enhance fraud control |
| Netherlands | 2013 | + | | | | More incentives for temporary workers and employers in case of long term illness. |
| Poland | 2013 | - | + | | | Eligibility rules more restrictive. More support for parents raising children. |
| Spain | 2013 | | - | | | Revised and less generous index used for calculating benefit amounts (law 27/2011). |
| | 2013 | | | + | | "Convenio especial" ensures continued contributions to old-age pensions for certain groups of unemployed with an incapacity. |
| Japan | 2015 | + | | | | Increase rates for low-income pensioners |

Note: A "+" means an expansion of eligibility conditions or an increase in generosity of existing programmes, or a new programme phased in. A "-" means the reform headed in the opposite direction. For Canada, information does not include Quebec. UB, UI and UA refer to unemployment benefits, unemployment insurance and unemployment assistance, respectively.

Source: OECD Tax Ben model and 2013 questionnaire on social policies in the crisis.

Table A2.3. Changes in Family-related Benefits (family benefit / child benefit / birth-related benefit / childcare benefit), selected countries, 2009-2012

| Country | Type of benefit | Year | Eligibility | Benefit level / duration | Programme phased in (+) / out (-) | Reform | Description |
|----------------|----------------------------|-----------|-------------|--------------------------|-----------------------------------|---|-------------|
| Austria | Family benefit | 2009 | | + | | One-off family allowance | |
| | Tax credit | 2009 | | + | | Increase in tax-credit for childcare | |
| Canada | Family related Tax Credits | 2011 | | + | | Several measures enhancing non-refundable tax credits for families with children. | |
| | Maternity Leave | 2012 | - | | | Persons no longer authorised to remain in Canada no longer eligible to EI maternity or parental benefits. | |
| Czech Republic | Income tax | 2009 | + | | | Temporary reduction on income tax for low-income families | |
| | Family benefit | 2011-2012 | - | - | | Social Allowance abolished, level of Parental Allowance more flexible and less generous | |
| | Maternity leave | 2009 | | - | | Decrease in replacement rate | |
| | Birth grant | 2011 | - | - | | More restrictive and less generous | |
| Estonia | Tax-break | 2009 | | + | | Increase for families with 2+ children | |
| | Tax credit | 2009 | | - | | Additional tax-relief removed | |
| | Family benefit | 2011 | - | | | Parents no longer eligible while receiving paid parental leave | |
| | Study loans | 2009 | | - | | For parents with children in school | |
| France | Family benefit | 2009 | | + | | One-off family allowance top-up | |
| | Income tax | 2009 | + | | | Reduction in bottom-tier tax | |
| | Childcare provision | 2009 | | + | | One-off increase in childcare vouchers | |
| Greece | Maternity leave | 2009 | + | | | Include mothers in the private sector | |
| | Child benefit | 2012 | | + | + | New means testing | |
| | Family benefit | 2012 | - | - | - | Extension of family allowance for third child onwards abolished | |
| Hungary | Family benefit | 2009 | | + | | One-off payment for low-income families | |
| | Childcare provision | 2009 | | + | | Extension for low-income families | |
| | Family benefit | 2011 | | - | | Temporary freeze on universal allowance | |
| Ireland | Maternity leave | 2009 | | + | | Increase in replacement rate | |
| | Childcare provision | 2009 | | + | | Free pre-school year | |
| | Child benefit | 2009 | - | - | | Reduction in benefit and age restriction | |
| Italy | Family benefit | 2009 | | + | | One-off payment to low-income families / temporary increase in family allowance | |
| | Birth grant | 2009 | | + | | Temporary lump sum payment | |
| | Family benefit | 2009 | | - | | One-off payment abolished | |
| Japan | Child benefit | 2010-2011 | + | | | Increase in amount | |
| | Birth grant | 2011 | | + | | Increase in amount | |
| Luxembourg | Childcare provision | 2009 | | + | | New voucher for children under 12 | |
| Spain | Birth grant | 2008-2010 | | | +/- | Birth grant introduced in 2008, abolished in 2010 | |
| Sweden | Family benefit | 2010 | | + | | Increase in amount | |
| United Kingdom | Child benefit | 2009 | | + | | Increase in amount | |
| | Income tax | 2009 | | + | | Increase in tax threshold for low-income families | |
| | Tax credit | 2009 | - | | | Reduction in income test threshold | |
| | Birth grant | | | | | Abolition of a "Health during pregnancy" grant | |
| United States | Tax credit | 2009-2011 | | - | | | |

Note: For Canada, information does not include Quebec.

Source: OECD Family database and 2013 questionnaire on social policies in the crisis. Note: A "+" means an expansion of eligibility conditions or an increase in generosity of existing programmes, or a new programme phased in. A "-" means the reform headed in the opposite direction. Countries were selected on the basis of reforms being probably linked to the economic downturn or fiscal consolidation.

Old-age pension reforms were often accelerated

137. In the early phase of the crisis, pension payments were often included in the stimulus packages, but they have now become a key component of fiscal consolidation (Table A2.4). At the onset of the crisis, one-off payments to retirees were introduced in a number of countries including Australia, Greece, the United Kingdom and the United States. These came on top of other increases in safety nets for the elderly. A few countries (*e.g.* Denmark and Iceland) allowed early access to pension savings, with the objective of supporting domestic demand. In parallel, however, reforms also continued to address the structural weaknesses of pension provision that became even more evident with the slowdown or decline in GDP. More recently, pension reforms have generally focused on either immediately lowering the cost of retirement (pensions freeze or de-indexation, *e.g.* Greece, Hungary and Ireland), or on restoring sustainability of pension systems in the longer term (lengthening of contribution period). Many countries tried to reduce costs and improve economic efficiency by increasing retirement ages and tightening early retirement conditions (*e.g.* Italy). However, in some cases, earlier reform steps were partially reversed (*e.g.*, the introduction of mandatory private pensions into retirement-income provision in Hungary and Poland). Some of these reversals are meant to be temporary, some permanent; some involve a complete retreat from compulsory private pensions and others a partial change of the system. Estonia, Hungary, Poland and the Slovak Republic are all affected.

Table A2.4. Changes in generosity or accessibility of old-age pensions, selected countries, 2009-2012

| Country | Pension Age (a minus means <i>less</i> generous eligibility rules) | Contribution Period (a minus means <i>less</i> generous eligibility rules) | Pension level | Programme phased in (+) / out(-) |
|---------------------------|--|--|------------------|--|
| Austria, 2010-2011 | - | | | |
| Belgium, 2012 | - | | | |
| Czech Republic, 2011-2012 | - | - | - | + |
| Estonia, 2009-2010 | - | | - | - |
| Finland, 2011-2013 | - | | | - |
| France, 2010 | - | - | | |
| Greece | - | - | - | + |
| Hungary, 2009-2011 | - | | - | - |
| Ireland, 2012 | | | - | |
| Italy | - | - | | |
| Netherlands, 2012 | - | | | |
| Poland, 2011 | - | - | - | |
| Portugal | - | | - | |
| Spain, 2011 | - | - | - | + |
| Slovak republic, 2011 | - | | - | |
| Slovenia, 2012 | - | - | | + |
| Sweden, 2009 | | | + | + |
| United Kingdom, 2012 | - | + | +/- | + |

Note: A "+" means more generous, i.e., an expansion of eligibility conditions or higher benefit levels for existing programmes, or a new programme phased in. A "-" means the reform headed in the opposite direction.

Source: OECD Pension database and 2013 questionnaire on social policies in the crisis.

In some countries health services were reformed to generate savings

138. **In the health area in particular, an important challenge is to achieve cost savings without compromising health outcomes and triggering even higher health-care costs in the future (OECD, 2010b).** The crisis has triggered substantial health policy changes, even if measures taken in response to the crisis are not always easy to identify and distinguish from previously planned structural measures to contain health care costs. The type of policy responses varied widely across countries and over time, but some general patterns can be identified (Morgan and Astolfi, 2013 summarise the main policy changes). Reductions of public health care supply were already planned before the crisis in a number of countries (*e.g.* Denmark, Germany, Poland, Slovak Republic, and Switzerland) but they were implemented with more intensity or speed during the crisis. Even in countries that have avoided a deep recession, governments have introduced health care savings measures to reduce government expenditure and debt (*e.g.* Australia).

139. **To achieve savings, many countries have relied on reducing the prices paid for health care services and products, or on a reduction of coverage.** Reducing the price paid for health care often means cutting wages and renegotiating pharmaceutical prices. These policies permit volumes of care to be maintained, at least over the short run, but generate a lot of controversy. Over the longer run, wage-cutting policies may also reduce the supply of labour among health care professionals and create subsequent health care shortages. Reducing coverage for certain population groups was often achieved through imposing income tests so that lower socio-economic groups retain their entitlements but wealthier groups face higher costs. In some cases, higher out-of-pocket payments, which affect in particular low-income households, were implemented although exemptions and caps have been put in place to reduce the impact on vulnerable population groups (Portugal, Spain).

140. **Many OECD countries have undertaken more structural reforms, aiming at improving the efficiency of the health care sector through changes in payment mechanisms, mergers of key institutions and purchasing arrangements.** These reforms are likely to require longer lead-in times before they have the desired effect, but these policies can have important implications on the long-term efficiency and productivity of the health care system. Countries such as Greece and the Czech Republic are implementing output-based funding mechanisms for hospital which have been shown to improve productivity in other countries. Stronger competition in areas such as community pharmacy may also provide greater consumer responsiveness and reduce prices.

Impact of fiscal measures on poverty and inequality

141. **At the onset of the downturn, fiscal policies, through taxes and benefits, have played a significant role in reducing poverty and inequality in OECD countries.** Previous work (OECD, 2008, Immervoll and Richardson, 2011) has shown that the redistributive effect of government expenditures and taxes acted as a significant “break” to the trend increases in inequality and poverty among the working-age population over recent decades. In the mid-2000s, taxes and transfers together reduced poverty by about 60% on average in the OECD (about 80% in Sweden and France, and 40% in the US and Japan). Importantly, social transfers to households contribute twice as much to the reduction in inequalities as taxes do. Transfers play a particularly prominent role in the Northern European countries, but also in France and Belgium, whereas taxes are a more important element of redistribution in Canada and the US. However, in half of the OECD countries, transfers have in fact become less redistributive since the mid-1990s. In the context of constrained social budgets, these patterns have two important implications:

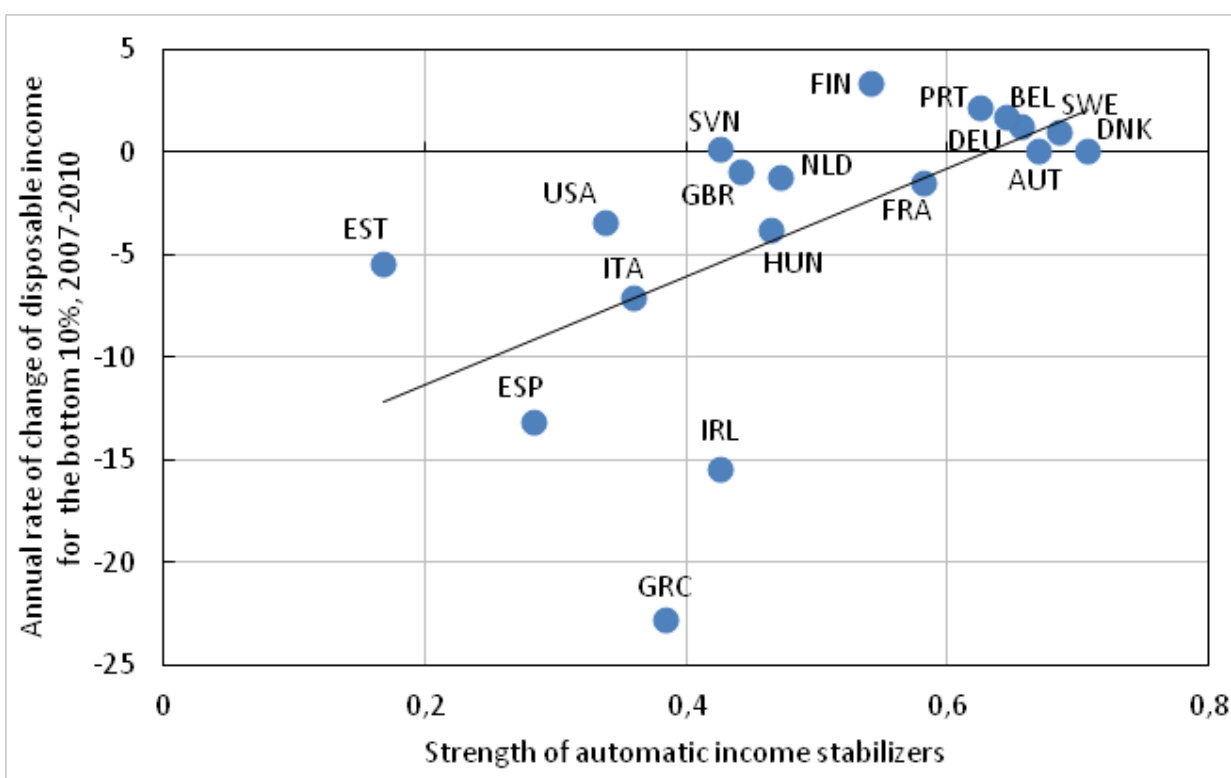
- First, it is very difficult to cut social spending, and transfers in particular, without increasing inequality. For instance, a simple simulation shows that cutting benefits by the same proportion

across all income groups would widen income inequality significantly, while tax-based consolidation would have the opposite effect (Rawdanowicz *et al.*, 2013).

- Second, there is scope for strengthening existing targeting mechanisms (*e.g.*, by preventing low income jobseekers from going without support).

142. Countries with strongly redistributive taxes and transfers have been better equipped to provide automatic income stabilisation initially. As shown in Figure A2.11, the income loss for the poorest 10% of households was substantially bigger in countries where automatic income stabilisers were relatively weak: as unemployment goes up, lower taxes and higher benefits provide less income cushioning in these cases. Again, transfers play a key role in this stabilisation effect because they are more important for low-income groups which suffered higher risks of non-employment (*e.g.* youth, low skilled), while taxes play a greater role for incomes in the middle and at the top of the distribution. Despite having automatic stabilisers of average strength, some countries experienced a strong decline in disposable income for the poorest over the 2007-2010 period (*e.g.* Greece or Ireland). In these countries, automatic stabilisers were not operating at their full capacity – either because fiscal pressures meant that the generosity of income support had to be reduced, or because some of the groups with particularly high unemployment risks in these countries (*e.g.*, youth or job losers with atypical employment contracts) did not have access to the full extent of income support.

Figure A2.11. Stronger automatic stabilisers were crucial in limiting income losses among the poorest



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

Source: Sources : Automatic stabiliser: Dolls *et al.* (2012), using simulations based on pre-crisis (2007) tax-transfer systems; Income change for the bottom 10% of the income distribution: Figure A2.4.

143. **Fiscal consolidation typically has a significant impact on inequality.** Clearly, fiscal consolidation measures constrain the room for manoeuvre for tackling the established medium-term trends towards greater inequality across the OECD. The precise economic consequences of fiscal consolidation measures are nevertheless the subject of an ongoing, and still evolving, debate. Existing findings are sometimes in conflict and must be considered with caution given technical difficulties of identifying effects in a reliable way. Although fiscal adjustments do have an impact on economic outcomes, economic outcomes also have an impact on the size of fiscal adjustment, meaning that one cannot interpret correlation as a causal relationships in any specific direction. The typical approach to solve this problem is to statistically separate changes in fiscal balances from economic influences (leading to a “Cyclically Adjusted Primary Balance”, CAPB, see Alesina and Ardagna, 2012).

- Along these lines, Agnello and Souza (2012a) found that successful fiscal consolidation episodes – defined as those succeeding in bringing public debt back to a lower level within 3 years - may actually *reduce* income inequality. This study is based on a long data series for 18 OECD countries covering consolidation periods between 1970 and 2010.
- However, in a more detailed analysis the same authors show that the impact on income inequality depends on the size and the composition of fiscal consolidation, with adjustments based primarily on large spending cuts leading to *rising* in inequality (Agnello and Souza, 2012b). According to these results, inequality goes up when the consolidation is modest (below 1% of GDP) and spending cuts exceed 0.8% of GDP. By contrast, inequality is estimated to fall if taxes rise by more than 0.6% of GDP.

144. **Alternatively, fiscal consolidation episodes can be identified directly based on policy documents to make sure they do not correspond to a mere adjustment to the economic cycle (the so-called “historical” approach).** In this case, research tends to confirm that adjustment costs are not shared equally and fall mostly on lower-income groups. Based on 173 episodes of consolidation undertaken in 17 OECD economies over the past 30 years, Ball *et al.* (2011) find that wage-earners lose more: for every 1 percent of GDP of fiscal consolidation, real wage income typically shrinks by 0.9 percent, while real profit and rents fall by only 0.3 percent. The decline in wage income also tends to be more persistent, notably due to increased long-term unemployment, and labour-market inactivity.

145. **Spending cuts tend to increase inequality more than tax rises do, and this can be the main policy concern in countries where lower-income groups have suffered significantly during the downturn.** But there is a parallel debate on the relative advantages of “tax” versus “spending” based consolidation strategies with regards to subsequent economic growth.

- Based on the CAPB approach, Alesina and Ardagna (2012) find that fiscal adjustments based on spending cuts are less likely to be reversed than measures that rely primarily on tax rises, that they have a smaller effect on economic activity, and that in combination with other policies they may be associated with stronger economic growth in the subsequent years. The main mechanism is that a decline in public spending without significant increases in taxes stimulates private domestic demand in the short term. This is the “expansionary austerity hypothesis”.
- However, based on the “historical” approach described above, there is less support to this “expansionary austerity hypothesis” for spending-based adjustments. Actually, spending-based adjustments still appear less contractionary than tax-based adjustments, particularly after the first year. But this stems primarily from the difference in monetary policy responses, with central banks easing their policies more often in the case of spending-based adjustments. In addition, some of the spending cuts during earlier episodes have taken place in a more favourable economic context which probably helped to reduce any damaging effects on longer-term growth (Gujardo *et al.*, 2011).

- However, looking beyond the distinction between consolidation on the spending or the revenue side, an assessment of the likely economic impact and trade-offs requires a close look at the measures being taken. For instance, drawing on existing and new empirical work, Cournède *et al.* (2013) find that increasing personal income taxes substantially damages long-term growth, but reduces inequality, whereas the opposite pattern holds for raising indirect taxes.

146. **The impact of fiscal adjustment on household income does not only depend on the size of fiscal measures but, crucially, on their composition and their timing.** Simulation methods based on household data can provide a deeper insight on how costs of consolidation are distributed across different income groups. They are also useful for looking at the likely effects of very specific policy measures that goes beyond the very crude distinction between spending and tax based measures. Avram *et al.* (2013) use such an approach to estimate the impact of actual fiscal packages in Estonia, Greece, Italy, Portugal, Spain and the UK. Although it is difficult to account in a realistic way for changes in labour market behaviour that can be induced by the consolidation measures, the study provides a very useful picture of the distributional mechanics involved in the measures, and of their immediate impact on household incomes. Results confirm that the distribution of adjustment costs between income groups depends strongly on the details of fiscal packages, and on population characteristics. As one might expect, the spending cuts that were implemented between 2010 and 2012 typically weigh more heavily on the bottom income groups, while tax increases have mostly affected higher-earning families. Overall, the early consolidation measures analysed in that study seem to have weighed more heavily on the upper income groups, as means-tested benefits were mostly protected from early cuts, while progressive taxes were increased (see Box A2.2). There are, however, large differences between countries and accounting for significant increases in indirect taxes, which are typically regressive, can change the overall conclusion (European Commission, 2013). Importantly, consolidation efforts that come into effect after 2012 may mean that the overall effect of all consolidation measures combined can look quite different. For instance tax and benefit reforms to be introduced during 2012-2013 period in the United Kingdom were found to produce the largest relative income losses among families in the bottom half of the income distribution (Joyce, 2012).

147. **Pre-crisis trends in redistribution policies and income disparities can moderate or reinforce the impact of fiscal consolidation on inequality** (Immervoll *et al.*, 2011; Jenkins *et al.*, 2012). Where the redistributive capacity of tax/benefit policies has weakened before the crisis (OECD, 2011), further consolidation measures risk having a greater impact on income adequacy. In addition, structural reforms over recent years, such as the introduction of measures to “make work pay” or to help reconcile work and family life, have frequently made social protection significantly more employment-friendly than they had been in the past. To the extent that countries were successful at reforming social protection in a way that encourages, rather than hinders, employment, cutting social spending can be expected to now have a more adverse effect on poverty and inequality than it did in the past.

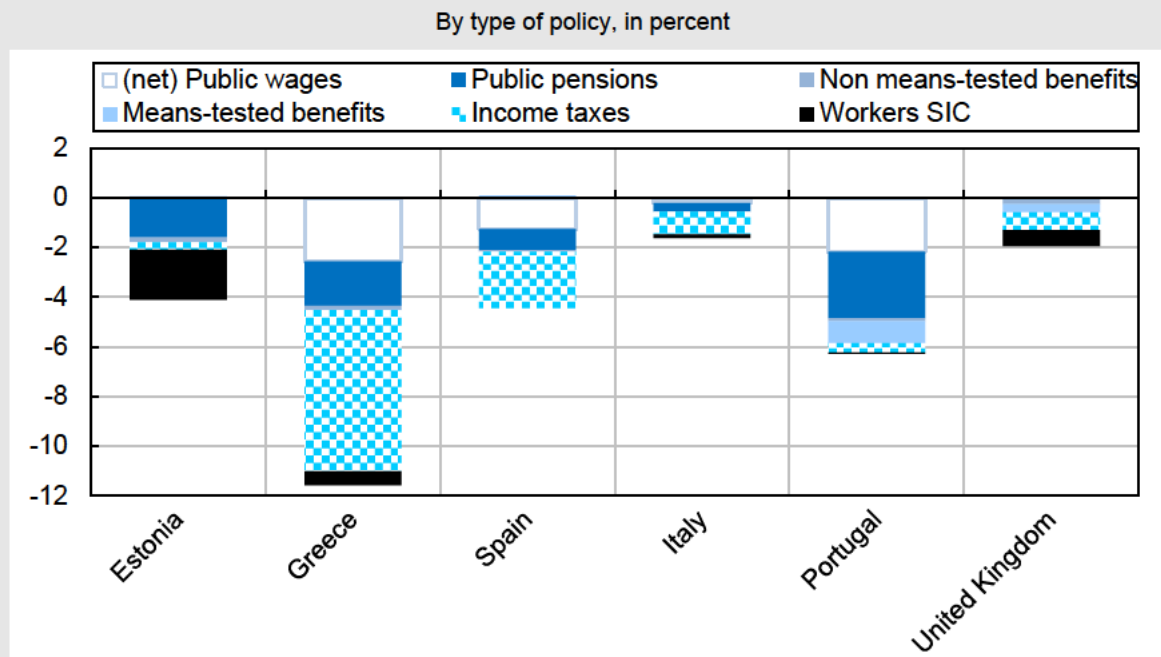
Box A2.2. The impact of fiscal consolidation packages in 6 OECD countries

Avram *et al.* (2013) is one of the very few studies that try to estimate the impact of concrete fiscal consolidation packages on household income and inequality. They simulate the distributive impact of such reforms with the EU tax-benefit microsimulation model (EUROMOD) on survey data from 2007 in six countries. They only consider consolidation measures that (i) have a direct effect on household income, and that (ii) were implemented between 2008 and 2012. The results are based on a straightforward comparison of the distribution of income with and without the introduction of changes in social transfers and direct taxation on the same population. One of their limitations is that they hold labour market behaviours constant, thus ignoring the impact of, sometimes sizeable, benefit and tax changes on labour market participation and working hours.

Results show a significant impact of spending reductions and tax increases on households' income, but also wide variation across countries depending on the details of fiscal packages. Results, illustrated in Figure A2.12, suggest that, in total, household incomes fall by between 2% in Italy and the UK and nearly 12% in Greece. Results also show that there has been no common approach to consolidating public budgets. Spending cuts typically weigh on the lowest

deciles of the income distributions, while increasing taxes weigh more on the upper deciles. But in practice, most countries have adopted a mix of expenditure cuts and rises in tax increases during the 2008-2012 period they study. Estonia has increased social insurance contributions and reduced public pensions. Greece, Spain and Italy have favoured increases in income taxes and reductions in public pensions and public sector wages. In Portugal most of the consolidation has been on the expenditure side, with cuts in public pensions, public sector wages and means-tested benefits. In the UK, the main bulk of the measures implemented up to 2012 have been on the revenue side, with increases in income tax and social insurance contributions (SIC).

Figure A2.12. Change in household disposable income due to fiscal consolidation measures 2012



Source: Avram *et al.* (2013)

The shape of the effect of fiscal consolidation measures across the income distribution varies across countries, with some of the early consolidation measures apparently weighing more on the upper deciles of income distribution. Means-tested benefits were often shielded from adjustment, while progressive taxes were increased. In Greece, Spain, Italy and the UK, the reductions in household income due to the early consolidation were found to be “progressive”, i.e. richer income groups contribute more in relative terms. In Portugal, the income reductions show an inverted U-shape pattern where middle income groups contribute less compared to low and high income groups. In Estonia, consolidation measures were clearly regressive, with larger income reductions for low-income groups. Estonia is the only country with a regressive distribution. Avram *et al.* (2013) also show that the distributive effect not only depends on which policies are implemented but also on how they are designed and where those affected are located in the income distribution. For example, cuts in public pensions can have very different distributive effects: While in Estonia and Spain the effect is clearly regressive (i.e., lower income groups contribute more in relative terms), in Greece and Portugal the reform affects middle and upper income households more.

Impact on health outcomes

148. It is too early to assess the impact of the current fiscal consolidation on health *outcomes* but some preliminary evidence suggests they may be significant based on the observed *outputs* of health systems. For example, various reports have indicated that some austerity measures are having an impact on hospital waiting times. In Ireland, for example, the percentage of patients waiting more than three months has increased from 45% in 2009 to 57% in 2011. This rise is the result of reduced hospital capacity, with associated falls in the number of inpatient admissions and higher occupancy rates in hospitals (Observatory, 2012). Delays in access can have an immediate impact on the quality-of-life of patients on

the waiting list, but can also have long-term health consequences if it prevents patients from receiving treatments at a time when these offer greatest clinical benefit.

149. **In the area of public health and infectious diseases, there has been a substantial rise in the number of new HIV cases reported.** In Greece, there was a 57% jump in new cases in 2011, with indications that 2012 will see an even higher incidence rate (ECDC, 2012). Unlike in previous years, the majority of new cases were among injecting drug users. Austerity measures leading to reduced funding for public health programmes can have serious consequences for populations at-risk and this is very likely to translate into higher health care expenditures in the future.

150. More generally, there is overwhelming evidence that long spells of unemployment and joblessness lead to worsened mental and physical health (see for instance Sullivan and von Wachter, 2009). It will be important for health systems to be able to respond to those needs, so that poor health does not become a barrier to workforce participation and future economic growth.

IV. POLICY RECOMMENDATIONS

151. **The challenge in the OECD area now is to achieve fiscal consolidation while avoiding a reversal of important pre-crisis reforms in a context of growing social needs.** Fiscal pressures on social programmes are substantial in many OECD countries, given their large weight in public spending on average. But social policies are essential for cushioning the damaging effects of the crisis, and for supporting self-sufficiency. They also maintain and stabilise demand for goods and services, which is essential for growth and future employment gains. To be effective, policies should account, as much as possible, for the circumstances of jobless individuals and other vulnerable groups. Although fiscal challenges constrain the room for manoeuvre, maintaining adequate funding for employment-friendly social policies can contribute to a stronger and a more job-rich recovery.

152. **Particular attention should be paid to the design of consolidation measures, since there is evidence from past episodes that the resulting burden is not born evenly.** Where social programmes are well targeted, social expenditures cuts tend to affect the poor more than tax increases. But there are many different ways of cutting spending or increasing taxes, and the distributional consequences of cuts may be very different, depending on their design and on demographic factors specific to each country. There is still considerable controversy about the short and long-term effects of different consolidation measures but there is evidence that past consolidation plans tended to bear less on profits than on wage-earners, and had lasting effects on the latter. Simulation exercises of the impact of fiscal consolidation suggest that cutting income support programmes can have a substantial impact on low-income families if policy changes are not adequately designed. A critical issue can be how people respond to consolidation measures, and this is an aspect that existing studies have not addressed fully. For instance, across-the-board reductions in resources for childcare or employment-support programmes could delay employment and earnings growth during a recovery.

153. **Unemployment, general social assistance and active labour market programmes account for less than 10% of public social spending on average in the OECD, but during the downturn, additional demands were particularly strong on these programmes.** Margins for savings in this area can still be small in the current economic context, and reductions in benefit duration and recipient numbers should ideally be achieved in line with the pace of the recovery. Partially automatic links between benefit provision and unemployment levels, as in the US and Canada, are examples of an approach that can facilitate a counter-cyclical policy response, although discretionary policy responses in both these countries were significantly more substantial than these automatic changes. Both discretionary and automatic policy adjustments need to be designed carefully, in order to avoid unintended effects, such as hindering mobility between regions with high and low unemployment. In addition, insufficient resources, as in the case of unemployment insurance funds in many US States, can make it difficult to maintain effective income support during extended downturns in practice.

154. **During the early phase of the crisis, unemployment benefits have acted as crucial automatic stabilisers, limiting the negative impact of job and earnings losses on household incomes.** As job losses mounted, unemployment benefits provided a first line of defence against income losses, and helped to stabilise incomes of newly unemployed and their families. Most countries with strong out-of-work benefits in place have allowed them to operate to the full extent. At the same time, the United States and some other countries with more modest benefit levels or durations, have acted quickly to bolster existing income support measures. Countries where social policies were adapted at the onset of the crisis, such as France, Portugal or the United States, have prevented a steep rise in poverty over the period 2007-2010.

155. **But with increasing long-term unemployment, other types of government support have become crucial for averting steep increases in poverty and inequality.** The central role of assistance benefits as fall-back options for those not, or no longer, entitled to unemployment support should be a primary consideration when designing, timing and the implementing necessary fiscal consolidation strategies. Cash benefits should continue to adequately support families in hardship, and minimum-income benefits need to be strengthened where unemployment remains very high, and where those affected have little access to other forms of support. Likewise, publicly-provided services or goods are an integral part of a balanced approach to supporting vulnerable groups, such as children, jobseekers, individuals with health problems or groups facing extreme economic hardship, such as the homelessness. Reforms of cash transfers and health care services currently under way should prioritise protecting the neediest with adequate targeting of measures.

156. **The long-term unemployed, who are often heads of families with children, should continue to be targeted by social safety-nets, especially in countries where the recovery is slow.** Exceptional and targeted measures, such as temporary extensions of assistance benefits for the neediest or exceptional food and housing supplements, can limit the rise in poverty. For instance, Finland recently enhanced its social and unemployment assistance programmes, while Austria reformed social assistance in a way that should be beneficial to families with children, and enhanced assistance benefits for unemployed in training. Low take-up of some key income replacement benefits for the working-age should also be addressed. In the United States, a series of measures before and after the onset of the crisis has made the Supplemental Nutrition Assistance Program (formerly “Food Stamps”) more accessible and, hence, significantly more responsive as a crisis safety-net.

157. **Labour market activation strategies and suitably designed in-work support, including for part-time workers, should be maintained at a reasonable level, while the type, sequence and intensity of activation measures should be adapted to the evolving labour-market challenges.** There is a strong case for designing government support in ways that harness and complement – rather than replace – households’ own capacities to adjust to adverse circumstances. The high fiscal cost of joblessness reinforces the case for well-funded active social policies, even if these are costly in the short term. But fiscal constraints may require a rapid transition from broad, stimulus-type programmes to selective and customised employment support. The best combination of policies will depend on labour market conditions as well. For instance, as the recovery gains momentum and promoting labour supply becomes more important, the focus of active labour-market policies should shift from labour-demand support towards in-work support for low-income working families. With large numbers of workless households, overarching objectives of “active” support include facilitating continued job search of all working-age family members, and ensuring that families benefit quickly once labour-market conditions improve. To be as effective as possible, work-related support should not be restricted to individual job losers, but directed at non-working partners as well.

158. **Beyond immediate redistribution, the timing, sequencing and targeting of fiscal consolidation has longer-term consequences,** although these are difficult to quantify and often disputed. For some areas of social spending, there is, however, strong evidence of distinct long-term benefits which should inform decisions on how to share savings efforts between different parts of health and social-protection budgets. In the health area, an important challenge is to achieve cost savings without compromising health outcomes and triggering even higher health-care costs in the future. Likewise, social policy measures that safeguard the wellbeing of children and youth – especially during the transition from school to work, and during the formative years of early childhood – are of particular importance and should be given priority.

159. **Specifically, youth need to be actively supported to avoid long-term “scarring” effects.** These “scarring” effects of labour-market detachment and of low-income spells mean that when the

recession ends, its impacts on youth do not. Governments should react swiftly to the observed increase in youth poverty and joblessness, but support should be targeted and geared towards activation. A number of countries have already introduced specific support measures for unemployed youth (*e.g.*, Portugal), and some have adopted comprehensive strategies to offer a solution to all youth neither in employment education, or training (*e.g.* the United Kingdom, Denmark or New Zealand). The Youth Guarantee's principles adopted recently by the EU Council go in the same direction. Ideally, under this approach cash transfers should be conditional on participating in vocational training, apprenticeship or other active programmes to provide youth with the skills required to access stable and good quality employment (see the recommendations in Annex I "Giving Youth a Better Start: An Action Plan"). These programmes should also provide access to affordable health care. Implementing this strategy can be challenging because it requires planning - and financing - of additional infrastructure and training capacities. But if well designed and suitably evaluated, these investments can lead to higher employment rates and lower dependency on social transfers throughout adult life.

160. **Fiscal consolidation measures should avoid across-the-board cuts of important supplements such as housing and child/family benefits which can make a difference for poor working families and lone parents.** Savings are achieved by reducing benefit levels, directly (*e.g.* Ireland) or progressively by de-indexing (*e.g.* Netherlands, United Kingdom). This approach, however, should consider treating the most vulnerable families differently in order to avoid poverty and long-term consequences on child well-being. More effective targeting on low income families can help achieve substantial savings in the short-run while protecting the neediest. Targeting is a tool that needs to be fine-tuned, however, to avoid disincentives to work. Female employment has turned out to be very important for sustaining household income during the crisis. Changes to family-related programmes and other social benefits should be designed in a way that ensures that work brings financial gains for women and their families.

161. **Key structural reforms of social protection systems that started before the crisis should continue. Successful reforms to pensions and health care systems are crucial for achieving fiscal consolidation while creating the necessary fiscal space to provide adequate support for disadvantaged groups.** Pensions and health care each represent approximately 30% of total public spending in the OECD on average and reforms in these areas can have very substantial effects on the overall fiscal situation. As for pensions, short-term and temporary reforms, such as the freezing of benefit levels, can have an immediate impact on public finance, but they may also increase poverty risks for low-income elderly unless supplemental measures are taken in parallel. More structural reforms, aiming at restoring the long-term sustainability of pension systems, such as increasing retirement ages and lengthening the necessary contribution period can achieve larger savings, although with greater delay. While short-term fiscal pressures may put specific features of public pension provision into focus, it is important to consider retirement income provision more broadly. The recent economic crisis will affect the future retirement situation of the current working age population, and an important challenge is to identify reforms that may be effective in alleviating the impact of the crisis over time and how these reforms would affect fiscal consolidation. For health care systems, structural measures that reduce unnecessary supply of services and those that achieve savings through efficiency gains are better options than untargeted cuts (such as higher co-payments) that limit access to health services for the most vulnerable.

162. **In the very short-run, addressing these challenges requires more knowledge about the populations at risk, how these risks are likely to evolve in the coming years, who is currently protected and who will be left aside, and how various groups would be affected by specific policy reforms.** The crisis has highlighted the crucial role of effective income support and services, and the importance of organising both public and private provision of social policy in a cost-effective way. Information on who is and is not covered, and how both social needs and social-protection coverage will evolve in the coming years, is only partially available. So far, very few studies have examined the impact in the short- and medium term of fiscal consolidation plans on living standards and on social outcomes

more generally. More work is urgently needed to gather evidence on these issues, and help build the right strategies and policy approaches that address both immediate social and fiscal concerns, as well as longer-term structural challenges.

163. **In the major emerging economies, the impact of the global downturn on economic activity tended to be less severe and shorter in duration than in most of the OECD countries.** However, some of the OECD area experiences during the crisis are highly relevant in emerging economies that are seeking to develop sustainable and “crisis proof” social protection systems. Inequality and poverty continue to be major policy challenges in emerging economies, and social budgets are comparatively much smaller than in the OECD area leaving many workers and households unprotected from economic shocks. The social policy challenges of securing adequate resources for social policy and, where necessary, of “doing more with less” are therefore faced in OECD and emerging economies alike. In emerging economies, structural and social reforms to improve the design and, importantly, the implementation of social protection, especially for the poorest parts of the population, need to continue. At the same time, redistribution programmes require a sustained policy commitment, and a sound fiscal foundation that enables countries to provide support in a counter-cyclical manner when economic shocks do occur.

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ANNEX III. TRUST IN GOVERNMENT: EVIDENCE, POLICIES AND DECISION-MAKING: A FORWARD-LOOKING AGENDA

Introduction

164. Against a background of slow growth, increasing unemployment and widening inequalities in many advanced economies, demands from citizens and business are high, but confidence that government can deliver remains often too low to support the implementation of the necessary reforms. Without trust in governments, public institutions and well-functioning markets, public support for ambitious, innovative policies is difficult to mobilise, particularly where short-term sacrifices are involved and where long-term gains might be less tangible. A decline in trust can lead to lower rates of compliance with rules and regulations. Citizens and businesses can also become more risk-averse, delaying investment, innovation and labour mobility decisions that are essential to regain competitiveness and jumpstart growth. Investing in trust represents an investment in economic recovery and social well-being for the future.

165. This note provides an overview of the influence of trust on policymaking. It looks at how trust can be defined, at what measures are currently available and how that measurement can be improved. It provides a summary of policy levers to strengthen trust in institutions, actors and decision-making processes at all levels of government. The analysis is a preliminary exploration of a subject on which more exhaustive research is urgently needed. It is essential to be able to measure trust, but the techniques available to us today are not always sufficient to inform evidence-based policy making. Drawing on the available evidence, the note discusses the many drivers of trust and identifies a number of ways that policymaking can be improved in order to ensure that policies are reliable, responsive, open, inclusive and fair. Effective action will help build trust in government, but, importantly, help demonstrate that governments also trust their citizens. Reforms need to be built on mutual trust. Indeed, the same principles for sound policymaking are also likely to strengthen the confidence of markets and the business sector in governments.

166. This note draws on a new report by the Public Governance Committee [[GOV/PGC\(2013\)1](#)] which highlights key policy dimensions for action by governments seeking to invest in trust: (1) *reliability*, the ability of governments to minimise uncertainty in the economic, social and political environment of their citizens, and act in a consistent and predictable manner; (2) *responsiveness*, the provision of accessible, efficient and citizen-oriented public services that effectively address the needs and expectations of tax payers; (3) *openness and inclusiveness*, a systemic, comprehensive approach to institutionalising a two-way communication with stakeholders, whereby relevant, usable information is provided, and interaction is fostered as a means to improve transparency, accountability and engagement; and (4) *integrity*, the alignment of government and public institutions with broader principles and standards of conduct that contribute to safeguarding the public interest while preventing corruption. An important point highlighted by the Public Governance Committee (PGC) is the importance of achieving an “optimal” level of trust that takes into account the cultural and contextual factors that influence absolute levels of trust from one country to another. It is important to optimise trust as a positive force in achieving policy objectives, with mutually consistent levels of trust between government and the citizens. At the same time, the report also highlights many gaps in our understanding and measurement of public trust that will need to be addressed if policymakers are to optimise trust and respond effectively to the expectations of citizens and other stakeholders.

167. A complementary report [[GOV/PGC\(2013\)2](#)] focuses on the process of policy making itself as a key anchor for trust in government. Trust in institutions is driven not only by the substance and outcomes of policies, but also by the way policies are designed and implemented, and the credibility of the actors and institutions involved. Governments need strong, credible and transparent institutions to provide assurance that policy decisions are fair, equitable and uphold the broader public interest.

A Forward-Looking Agenda – A Strategy on Trust?

168. Looking ahead, the OECD has an opportunity to lead a policy debate on how greater trust in both public and private institutions and actors can contribute to the achievement of key economic and social objectives. Policymakers are well used to thinking in terms of “strategies” for growth, jobs, investment and other things. The current economic and social context suggests the need now to think in terms of a Strategy for Trust. A forward looking agenda on trust in government would aim to identify the main measures to restore trust in government and confidence in public institutions and explore how the OECD can help governments to implement reforms to restore trust. A policy agenda would address closely related dimensions of public confidence in public institutions, both national and sub-national, and private institutions to deliver effective policies, for example:

- Building the evidence base assessing the robustness of existing methodologies to measure trust in government and key institutions, and developing new metrics that are more policy focused;
- Strengthening capacity for strategic foresight, helping to manage complex challenges in a context of uncertainty and risk;
- Open government – inclusive and responsive policy making;
- Strengthening integrity and ensuring fairness in policy making.

169. A comprehensive agenda on trust has to fully acknowledge the institutional dimension, and address policy and decision making processes for inclusive policy making. This would include analysing the role of non-government actors (business, civil society, political parties, etc.) and the influence that they exert on policy, offering a better understanding of the broader context under which policy decisions can be exposed to undue influence of money and vested interests. This initiative would systematise knowledge in areas that have already been explored by the OECD, such as lobbying, conflict of interest and consultation (but for which implementation remains an issue) and would offer an opportunity to close the remaining gaps in others, such as political financing, parliamentary work and social media.

Why trust in institutions matters? Why today?

170. The financial and economic crisis highlighted serious governance and regulatory failures, be they related to poor articulation of regulation, limited enforcement of rules or regulatory capture. The crisis reawakened a debate on the role of the state in the economy, and on how and where it should intervene to achieve which objectives. Public actors and institutions were blamed for their failure to cope with the financial and social crisis. The notion of the state as the careful and competent steward of the public interest has been damaged in many countries, and these sentiments have been heightened by concerns about fairness in fiscal consolidation and in the sacrifices required for structural adjustment. The issue of trust, and specifically trust in government, has come to the fore.

171. The issue of trust is not new. Trust in government is recognised as one of the most important and basic foundations upon which the legitimacy and sustainability of political systems are built Box A3.1. Trust is essential for social cohesion and well-being as it affects government’s ability to govern and enables government to act without having to resort to coercion. Consequently, it is an efficient means of lowering transaction costs in any social, economic and political relationship (Fukuyama, 1995). A high level of trust in government also increases the efficiency and effectiveness of government operations.

172. But trust appears to be particularly important for policymakers today. This is because the difficulty in tackling economic and social challenges is hurting confidence in government and institutions. The crisis led some to feel that governments are not able to effectively regulate markets today, that business exerts an undue influence over public policy and that the distribution of burdens and rewards

across society is skewed. The crisis is adding to a number of structural factors that have already been weakening the relationship between government and citizens in many countries. The challenge of maintaining trust is complicated due to the difficulties governments face in addressing the changes raised by a faster and more diversified flow of information across society. Together these suggest a more complex environment for governments with respect to maintaining the confidence of stakeholders. Governments need to balance multiple challenges and understand trade-offs, while operating in a more open and consultative manner.

Box A3.1. A definition of trust: Trust in What and in Whom?

Trust in government represents confidence in the actions of government to do what is right and perceived to be fair. For presentational and clarity purposes, this report will use the word "Trust" to qualify this perception. At a general level, trust means holding a positive perception of the actions of an individual or an organisation; it is thus a subjective phenomenon. Therefore, it is important to identify trust in government by whom. A first important group consists of citizens and their organisations, including civil society organisations; and a second group of businesses and their organisations. Citizens matter first and foremost as voters in a democratic context. Together with businesses, they are also taxpayers and clients of public services. The trust of government employees in their own government is also a crucial, but often overlooked aspect of trust in government (Sobiech, 2012).

173. The way trust influences policy outcomes is complex, but some of the main factors are the following:

- **Trust in institutions influences individual behaviour in ways that support desired policy outcomes.** This may range from rather narrowly defined policies and programmes (vaccination campaigns, preschool education, conditional cash transfers) to broader policy agendas and reforms (innovation, environment, social security). Trust is important because many public programmes create the opportunity for free riding and opportunistic behaviour. These problems increase in proportion to the public good component of a policy. Trust reduces the risk of such behaviour to the extent that people are prepared to sacrifice some immediate benefits if they have positive expectations of the longer-term outcome of public policies, either at a personal level (pensions) or by contributing to the common good (redistribution).
- **Trust in institutions improves compliance with rules and regulations and reduces the cost of enforcement.** Rules and regulations are never perfect or complete enough to eliminate abuse. Their effectiveness depends on the extent to which people see them as fair and legitimate enough to outweigh the benefits of non-compliance. This is particularly important for regulations where the gap between the cost of compliance and personal benefits is large and where control is more difficult. For example, mistrust in government undermines tax compliance, which in turn reduces revenues available for social expenditures. Citizens are more likely to perceive tax obligations more favourably, and comply with those obligations voluntarily, when their government is seen to be acting in a trustworthy manner. It is therefore essential for governments to ensure that all taxpayers pay their fair share.
- **Trust in institutions may contribute to increased interpersonal trust or "social capital"** by enforcing the values of truth-telling, promise-keeping, fairness and solidarity. A central claim of institutional economics is that interpersonal trust reduces the transaction costs of doing business across the economy, raising productivity and competitiveness.
- **Trust in institutions helps to increase confidence in the economy** by facilitating economic decisions, such as on investment and consumption that foster economic growth. Trust in institutions as well as interpersonal trust may reduce the perception of risks linked to decisions

ranging from the consumption of durables to job mobility, worker hiring and investment. This, in turn, supports economic growth and extends the planning horizon of economic agents, increasing economic dynamism.

- **Trust in institutions may help governments to implement structural reforms with long-term benefits** by allowing political actors to co-operate in building sustainable solutions to complex economic and social problems. Many reforms involve sacrificing short-term satisfaction for longer-term gains, and will require broad social and political consensus to be effective and sustainable. In a high-trust environment, such reforms can not only be properly implemented, but sustained long enough to bear their fruits. This gives a longer time frame for policy decisions. In a low-trust climate, citizens will prioritise immediate, appropriable and partial benefits, and will induce politicians to seek short-term and opportunistic gains through free-riding and populist attitudes.

Measuring trust in government: the need for a better evidence base

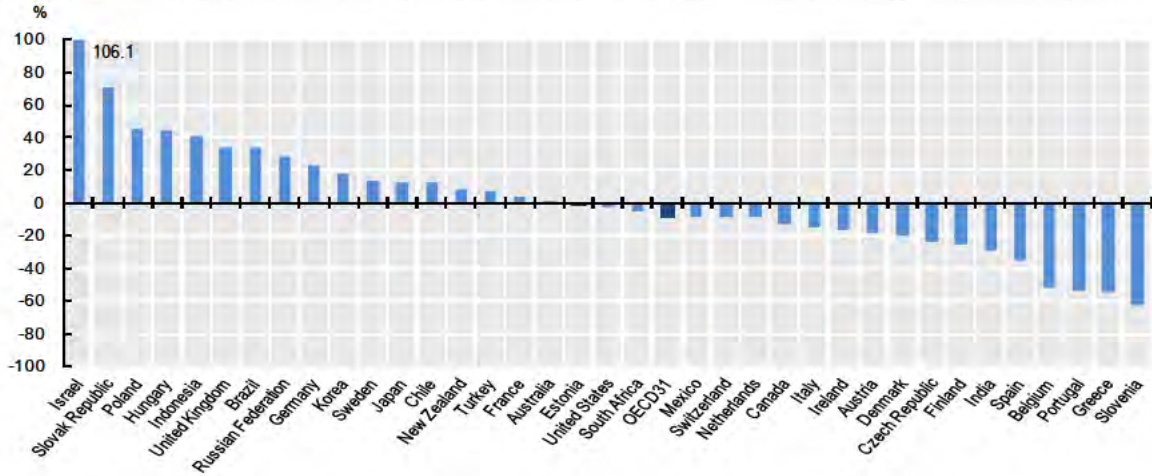
174. Trust is a matter of perception and its measurement is fraught with many challenges. This is true at the national level, and even more so at the international level, when using perception surveys. Levels of trust in government vary from country to country for many reasons, some of them cultural and context-specific. The absolute level of trust at a particular moment across countries tells us less than the trends and evolutions over time, which are more likely to better reflect the changing sentiment of citizens and businesses. This changing sentiment, in turn, can be influenced by a wealth of factors, some of which are connected to economic expectations and others to governance aspects and government performance.

175. In terms of perception surveys, several international tools exist for measuring citizens' trust in and perceptions of government, but they differ in the type of action or institution that they measure, the frequency of the survey and geographical scope, raising comparability issues. None of the existing surveys cover all OECD countries for an extended period of time, making it difficult to gain a thorough understanding how citizens' trust in government is evolving over time and what influences levels of trust in government across OECD countries and beyond. Perhaps most importantly for the purpose of this analysis, the surveys were not designed to support policy analysis or lead to policy recommendations – in other words the questions asked are not those that an OECD survey would necessarily choose. At the same time, the surveys used here are those most often cited and publicised: Gallup, Eurobarometer and Edelman [[GOV/PGC\(2013\)1/ANN](#)].

176. Using the Gallup World Poll, from 2007 to 2011 the share of respondents expressing confidence in national government in 31 OECD countries has declined on average by 3 percentage points from 44 % to 41% (Figure A3.1). This average decrease, although relatively small, masks large variations: 13 of the 31 countries reported an increase in confidence, 2 remained at the same level, and 16 reported a loss of confidence from 2007 to 2011. Even more significant drops in trust occurred in countries facing either a political, fiscal or economic crisis. In other countries, however, confidence in government actually increased, notably in Israel, the United Kingdom, the Slovak Republic, Hungary, Poland, Germany, Sweden and Chile.

Figure A3.1. Confidence in national government, change between 2007 & 2011 (Gallup World Poll)

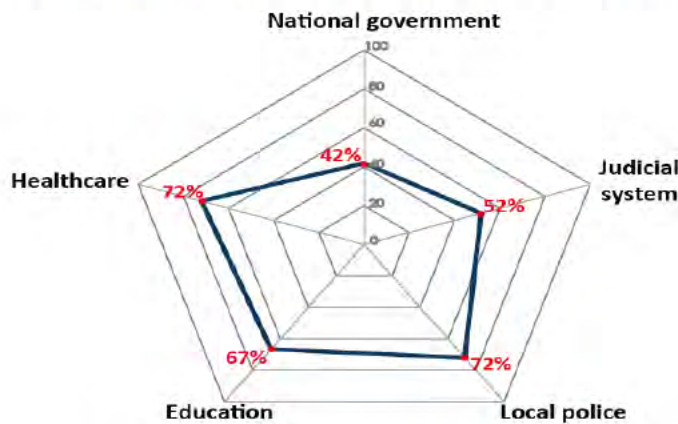
Change in % of those answering "tend to trust" to the question: do you have confidence in the national government?



Note: Percentage changes for those who answered "tend to trust" to the question: do you have confidence in the national government? 2006 data instead of 2007 for Austria, Finland, France, Ireland, Norway, Portugal, Slovak Republic, Slovenia and Switzerland. 2010 data instead of 2011 for Chile, Israel, Japan, and Brazil. 2009 data instead of 2011 for Switzerland. 2008 data instead of 2011 for Iceland and Norway. Source: World Gallup Survey.

177. Trust also varies significantly across institutions, with confidence in government and the judiciary tending to lag behind confidence in institutions relating to core public services such as education, health and policing Figure A3.2. In 2011, on average in the OECD countries confidence was the highest in health care and the local police (both 72%) followed by education (67%), the judicial system (52%) and the least in national government (42%). This highlights the importance of understanding what we mean by government – when citizens identify their level of trust in government, which elements of the broad network of actors, institutions and regulations that make up government, as well as the infrastructures by which services are delivered, are they really referring to?

Figure A3.2. Confidence in different segments of government, OECD average, 2011



Note: Confidence in national government: % of respondents who answered 'yes' to the question: "in this country, do you have confidence in National government?" Confidence in judicial system: % of "yes" to question: In this country, do you have confidence in each of the following, or not? How about Judicial system and courts? Confidence in local police: % of "yes" to question: In the city or area where you live, do you have confidence in the local police force, or not? Education system: % of "satisfied" to the question: In the city or area where you live, are you satisfied or dissatisfied with the educational system or the schools? Healthcare: % of "satisfied" to the question: In the city or area where you live, are you satisfied or dissatisfied with the availability of quality health care? 2010 data instead of 2011 for Chile, Israel, Japan and Brazil. 2009 data instead of 2011 for Switzerland. 2008 data instead of 2011 for Iceland and Norway. Source: World Gallup Poll

178. Trust tends to be highest at the local level, where services are delivered and where the link with government performance is most concrete. Trust also tends to be higher for actual users of public services than for the non-users. An exploration of the variations of trust across levels of governments and across different types of public institution would provide some clues as to the factors that shape public perceptions of government and different policy levers can improve the perception of those areas of public administration.

179. These results are exploratory, limited by the nature of currently available data. Nonetheless, they show the need for more comprehensive measurement. Further work is clearly required to explore in more depth the relationships between trust in government and in the different components of government and dimensions of government performance in order to draw conclusions that could identify areas where government action can make a difference.

The drivers of trust: reliable, open, inclusive, fair and clean government

180. Trust in government is multifaceted and based on a mix of economic, social and political interactions between citizens and government. It can be analysed at three levels. At the macro level, trust relates to political institutions and the functioning of democracy. At the meso level, trust relates to strategic policymaking – the ability of governments to manage economic and social issues, and to generate positive expectations for future well-being. Finally, at the micro level, trust refers to the impact of government on people’s daily lives through service delivery. Although distinct, these three levels interact and a significant lag in trust at one level will affect trust at other levels and influence policy outcomes. Efforts to strengthen trust therefore need to reinforce synergies across each of these different spheres. Citizens are sensitive not only to the content and outcome of policies, but also to how policies are designed and implemented and fit with broader standards of behaviour. It is not only the “**what**” of policies that matters, but the “**how**”, the “**for whom**” and the “**with whom**”.

181. There are different dimensions to consider when looking at trust in government, for example: a) trust of citizens and organisations in government, b) trust of government in citizens and organisations, c) trust within government, across agencies and the public sector as a whole. Citizens also need to feel trusted and this component should not be neglected. An open and responsive government is an enabling environment to reinforce trust between government and citizens in both directions.

182. The public governance dimension includes a set of inter-related drivers that encapsulate what citizens expect from government:

- *reliability*: the ability of governments to minimise uncertainty in the economic, social and political environment of their citizens, and to act in a consistent and predictable manner;
- *responsiveness*: the provision of accessible, efficient and citizen-oriented public services that effectively address the needs and expectations of tax payers;
- *openness and inclusiveness*: a systemic, comprehensive approach to institutionalising a two-way communication with stakeholders, whereby relevant, usable information is provided, and interaction is fostered as a means to improve transparency, accountability and engagement; and
- *integrity*: the alignment of government and public institutions with broader principles and standards of conduct that contribute to safeguarding the public interest while preventing corruption.

183. A broad empirical literature discusses the relationships between trust in government and economic, social and governance parameters. While there is more or less a consensus on the range of drivers involved, the evidence is conflicting on the magnitude of their influence and the depth of their reciprocal relationship with trust. A general finding is that trust and most of its drivers are interlinked and self-fulfilling, and therefore complementary in their relationship to public governance and economic development.

Reliability of government

184. Governments in their steering and political functions have an implicit obligation to minimise uncertainty in the economic, social and political environment of their citizens. This is particularly true with respect to external events over which citizens have limited or no control, such as disasters or economic crises. This, in turn, implies (i) that the State acts as the careful steward of the public interest, and (ii) that its actions are consistent and predictable.

185. The crisis and other recent disasters were a severe test of the ability of governments to play this important “stewardship” role, raising a number of important questions that have implications for trust in government:

- Is the government able to identify challenges and assess risks for society? Does the government have mechanisms to mitigate such risks?
- Are the strategies of public bodies aligned to a more general strategy that takes into account challenges and risks?
- Does the public service have the competencies to deliver on institutional commitments, including prudent financial management?

186. Answering these questions requires government action on a number of fronts, from centres of government and budgeting officials as well as the capacity to develop strategic foresight to manage risks.

Strategic capacity in centres of government

187. Despite being a key function of the centre of government, long-term planning and risk management may have received insufficient attention in recent years. The crisis demonstrated that governments were ill-prepared to react to rapidly occurring and overlapping crises – on the one hand, they had too little evidence and analysis and, on the other, too little agility and flexibility in the organisation of responses and reallocation of resources. Recent meetings of the Centres of Government network (CoG) highlighted the limited resources at hand within government to ensure that policymaking is “reliable” – i.e. predictable, coherent and effective. Weaknesses vary from country to country – in some cases, strategic foresight units were poorly resourced or had been closed; in others, long-term strategic plans were not well connected to budgeting and therefore had little impact on resource allocation. Ownership by line ministries of whole of government strategic goals was often weak, and political economy factors sometimes worked against selling a long-term strategy to legislatures, particularly in a period of economic and social pressure. As a result, government action has too often been seen as disjointed, lacking a clear “narrative” and the capacity to “make sense” of complex issues.

188. Reliability ultimately depends on the ability of the public service to implement policy. Reliable policymaking requires developing a long-term vision for the public sector that goes beyond short-term cuts and lays the foundation for the kind of civil service needed to fulfil that vision. The vision includes strengthened planning functions and spending reviews or similar actions to identify core activities. The

second element is the improvement of central-level monitoring, including specialised evaluation units and more regular reporting by departments on progress in implementation. A third element is greater use of consultation and a stronger focus on user satisfaction and feedback (see section below on open and inclusive government).

The role of sound fiscal management

189. Sound fiscal management is also a key parameter for restoring trust. In a sense, it implies repairing the budget contract between citizens and the State: the budget can be viewed as a contract that establishes rights, obligations and expectations; assigns roles and stabilises relationships among participants; promotes continuity in policies and allocations from one budget cycle to the next; and reduces both the volume of decisions and the intensity of conflict. The idea of a budget as a contract is not new, but has renewed salience in post-crisis countries. The Great Recession has impaired both explicit and implicit budget contracts in many OECD countries, compelling the most affected ones to abandon established policies and to seek political support for sustainable revenue and expenditure policies. Countries that have escaped financial destabilisation may still have to reconsider existing budget policies in order to cope with the financial burdens of ageing populations.

190. In the end, it is the misalignment of expectations and capacity that has damaged budget contracts and citizen perceptions. Dampening expectations is a difficult challenge in democratic societies that have been led to expect progressive improvement in economic well-being and government-financed benefits over time. Rewriting budget contracts is only one of the adjustments needed to restore public trust by bringing citizen expectations and government capacity into balance. Changes in private and social structures and relationships may also be necessary, along with political reforms that make governments more accessible and transparent.

Risk and crisis management

191. One of the most important responsibilities of any government is to ensure the security and safety of its citizens and territorial integrity of the nation, including protecting the institutions that sustain confidence, good governance, and prosperity. This implies pro-active efforts both to mitigate known risks (derived from all-hazards or threats - man-made, environmental or social) and to prepare for the unknown. Given the wide range of hazards and threats facing a country - fires, floods, earthquakes, hurricanes, pandemics and terrorist attacks - governments face difficult trade-offs about where to invest limited resources to prevent civil contingencies and improve the ability to handle those that do occur. Disasters have widespread impacts, causing not only harm and damage to lives, buildings and infrastructure, but also impairing economic activity, with potential knock-on effects across economic sectors and across borders.

192. Therefore the level of trust a government enjoys is highly dependent on its capacity for managing risks. Such a capacity includes steering and leadership, proactively identifying the risk of future disasters, and managing crises when they occur. Awareness of the importance of crisis management in government and the private sector has risen dramatically in recent years as major shocks have, arguably, become more common and more destructive, at least in terms of economic losses. The issue of how governments prepare for such events has broadened from a national or regional public policy concern to a global challenge. The concept of “global shocks” describe the cascading of risks in health, climate, social or financial systems that touch many countries simultaneously. The global interconnectedness of OECD and global partner economies could make these global shocks more likely to happen.

193. Good governance in risk management requires strategic focus, inter-agency co-ordination, a commitment to the protection of fundamental rights, tools to ensure cost-effectiveness, policies for accountability, and the capacity to respond and adapt to any novel challenges. Therefore, governments need to prioritise and co-ordinate responses and resources across several fronts at once. The strained

situation of public finances may radically alter long-term perspectives, with a need to better identify and manage contingent liabilities, as governments find it increasingly difficult to play the implicit role of insurer of last resort. A challenge for governments remains where to invest limited resources to achieve highest value.

Responsive government

194. Trust in government also depends on the perceptions by citizens when receiving public services. The interaction between citizens and the state happens on an everyday basis, and is a crucial factor of trust in government. Under tight fiscal constraints and growing expectations, governments are increasingly engaging with citizens to ensure quality, responsiveness and ultimately trust in public services. Governments are also exploring how improved service delivery can boost confidence and trust in the public sector. While causal links between public service delivery and citizens' trust and confidence in government are difficult to pinpoint directly, recent country studies have shown a relationship between citizens' experience with government services – including employee and citizen engagement in co-design, co-production, co-evaluation as well as delivery of public services – and trust and confidence in governments. One common finding of studies in Canada, France and the UK is that trust in government tends to be higher at the local level, and that citizens tend to trust government when they perceive it as a service provider.

195. Studies in several OECD countries suggest that improving service delivery responsiveness can improve not only satisfaction in the quality of services themselves, but also confidence in the public sector and government. Still, this is subject to asymmetrical psychological effects: the impact of a negative experience on trust is much more pronounced than the effect of a positive one. Governments need to find innovative solutions to respond to fast changing needs with limited resources in order to preserve responsiveness and a client focus. The OECD Observatory on Public Sector Innovation has the potential to help with sharing solutions and creating communities of practice on public sector innovation.

196. Creating more efficient and responsive public services also means understanding citizens' needs and involving them in the production and design process. Involving citizens in the evaluation and design of public services through innovative tools can increase transparency, improve quality and build trust. Many countries such as Finland and France (Box A3.2) have begun to use barometers allowing citizens to evaluate their experience with public services. Efforts to monitor outcomes and adjust services accordingly are important to achieve results over time. This requires greater efforts to ensure that services are well evaluated and quality improves as a result, even though this may only result in modest improvements in trust, and this is only one part of the solution.

Box A3.2. The "Barometer of public services"– France

The Barometer is an innovative tool in assessing the quality of public services from a user perspective. It retains key variables such as response times to written requests, emails and phone calls. But it broadens the scope of assessment by using indicators that relate to specific "life events" of public service users (e.g. "I need urgent medical help") and to the existence of formal complaint mechanisms. Quality in these areas is measured using both "objective" indicators of performance (e.g. response times) and "subjective" indicators of user satisfaction (through surveys conducted with a representative sample of the population that has had contact with the public administration in connection with life events analysed by the Barometer). Although the barometer started only recently, it has the potential of becoming a good practice for gauging user satisfaction, creating transparency and building citizens' trust. (OECD, 2012).

197. Focusing on the key drivers of public service satisfaction, including elements such as engaged (or responsive) public servants, can help build citizens' trust in government. Nonetheless, further research into the Public Sector Service Value Chain (PS SVC) and the link between public service satisfaction and trust

in government would help. Finally, public service satisfaction also depends on macro-elements such as the overall functioning of the real economy. The level and quality of public services depend on how much the state can afford. This is a challenge in tight fiscal times, as it needs to be considered in the context of the framing conditions for sound fiscal management highlighted above.

Open and inclusive government

198. In a broad sense, open government policies, including citizen engagement and access to information can be leveraged to increase trust. It is rationally expected that more transparent government policies, procedures and institutions will bolster trust. More open and inclusive policy making processes help to ensure that policies are better informed and will better match citizens' needs. In general, policy-makers in OECD countries and beyond broadly agree that facilitating the participation of citizens might enhance democratic engagement, build trust in government and harness productive forms of responsibility, including in the delivery of public services.

199. Previous OECD work on public governance shows that OECD countries have put forward a number of mechanisms to support open and inclusive government, from access to information, to consultation processes, to full-fledged open government policies (OECD, 2009). At the heart of these efforts is the goal of increasing citizens' trust: 61% of OECD countries report trust to be their main goals when investing in openness and engagement of citizens, with others including strengthening social cohesion, raising awareness or increasing citizens' scrutiny.

200. While the intrinsic value of participation is beyond doubt, the business case is still to be made, as the impact of open government policies has not always been systematically assessed. Nonetheless, the process itself is important, and the credibility of the process of policy formation and of the actors participating in it has been demonstrated to have an impact on the predictability and enforcement of public policies, which in turn strengthens their impact. More work, and more opportunities for the exchange of practical experience is required, not only to identify and learn from successful experiences and failures, but to better assess their impact on stated objectives and broader policy goals.

201. For example, in Mexico, civil society organisations have used the 2002 Access to Information Law to obtain information that has helped identify poor or ineffective policies, wasteful or abusive public spending, or corruption. In Iceland, after the 2008 crisis, citizens were actively taking part in drafting the new (crowd-sourced) constitutional bill of Iceland. The United States federal government launched a citizen oriented monitoring tool in 2009 to accompany the execution of the American Recovery and Reinvestment Act (www.recovery.gov) and facilitate (i) greater accountability and transparency, and (ii) reporting of suspected fraud, waste, or abuse related to stimulus funds. From February 2009 to December 31, 2012, the Inspector General has reported 4 210 complaints of wrongdoing associated with Recovery funds to the Recovery Board. 2 114 of these have triggered open investigations.

202. In addition, a full institutionalisation of openness and inclusiveness is facing regulatory and implementation challenges, as highlighted by the issue of access to information, which remains partly incomplete in a number of countries, even those that have implemented access to information laws.

203. While the expectations around transparency and its relationship with trust remain a matter of political traditions, and require participation from an active and well engaged civil society, Open Government initiatives are receiving traction in an increasing number of Member and non-Member countries. Not only are countries moving forward with the implementation of open government policies, but these efforts have resulted in an international movement, the Open Government Partnership in which 19 OECD Member countries have country commitments (Box A3.3). The extent to which its full potential is leveraged will depend on the way in which countries seek to implement this broad concept. It will also be important to assess the real scope and impact of the concept.

Box A3.3. MENA-OECD Open Government Project

In the context of a G8 mandate through the Deauville Partnership, a **MENA-OECD Open Government Project** has been established to support Jordan, Libya, Morocco and Tunisia to implement public sector reforms inspired by the principles of good governance and open government, with a view to join the Open Government Partnership (OGP). Working with other donors and development actors, the OECD has paid particular attention to the political and institutional developments in beneficiary countries, so as to align activities to national reform agendas. The Project was made possible thanks to the financial support granted by the US Middle East Partnership Initiative (MEPI), the German Federal Foreign Office and the UK Foreign Office.

In particular, the project is:

1. Helping **Morocco** and **Tunisia** to become full members of OGP by supporting their current reform process with policy recommendations based on an assessment of their legal, institutional and policy gaps.
2. Assisting **Jordan** in the implementation of its OGP Action Plan. The OECD is currently providing policy advice and technical assistance to key Jordanian stakeholders through capacity building seminars, policy dialogue and exchange of good practices that build on the OECD networks of peer policy makers and practitioners. The current focus, as requested by Jordanian authorities, is on making reform happen and citizens' engagement.
3. Forging strategic alliances with key development partners (i.e. UNDP and OECD member countries' embassies and co-operation offices) to support building administrative capacities in **Libya** which suffers from extreme institutional weakness and lack of capacity at the political level of the central government.

Several other countries from the **MENA region, Latin America, Sub-Saharan Africa** and **Southeast Asia** have asked OECD support to draft or implement policies in various areas of Open Government. These new collaborations are expected to start in the second part of 2013.

Access to information and open data policies

204. Access to information and open data policies are key concrete pillars for promoting open government. The Freedom of information laws (FOI) - also referred to as access to information laws represent the early stage of those policies. These have been supported by a "Right to Information" movement promotes a public right of access to information from a human rights perspective. These laws contribute to strengthening transparency, enhancing government accountability and promoting informed participation in policy making, which are recognised as key preconditions to increase public trust. All but one of the countries responding to the OECD 2010 Open Government Survey appeared to have FOI legislation/regulations.

205. A second phase in access to information corresponds to the Open Data movement, which uses predominantly social and economic arguments to encourage the opening up of government data. The release of data into the public domain can not only contribute to increased government openness, but can also benefit society by creating conditions for more inclusive service delivery and more participatory processes.

206. Finally, it is important to acknowledge that increased transparency does not automatically drive greater accountability. A government can be open, in the sense of being transparent, even if it does not embrace new technology and a government can provide open data and still remain deeply opaque and unaccountable (Robinson, Yu, 2012). Making public sector data available in machine-readable format can improve service delivery and citizens' quality of life, while having little impact on political accountability and public trust. It is important that open government initiatives are not relegated to the realm of technical projects, but are embedded in the broader discussions and strategies that aim to foster openness and inclusiveness of governments to regain the public trust.

Budget transparency

207. The budget is a government's single most important policy document, where policy objectives are reconciled and implemented in concrete terms. In the context of the OECD Best Practices on Budget Transparency, it is defined as the full disclosure of all relevant fiscal information in a timely and systematic manner. However, while publishing budget data is an important step for increasing transparency, challenges remain as to how to ensure that the data is comprehensible and digestible for citizens and their representatives in the legislature: it is unlikely that “dumping” large amounts of raw budget data online will increase trust, but pulling together data to create cohesive stories that increase the knowledge of citizens and other stakeholders on how money is being spent could do so.

208. This implies establishing processes for cleaning and preparing data; developing tools such as calculators or visualisation tools that allow the public to more easily explore and understand the budget in greater detail; and designing web platforms for publishing that seriously consider user experience. Where data is less accessible, other actors such as data journalists or independent institutions undertaking budget analysis may act as filters for the public. The New York Times federal budget visualisation, WallStats Death and Taxes poster, or the Guardian's visualisation on government spending by department are examples of popular visualisations on public spending. The United States Congressional Budget Office established a rule of being clear and concise in presenting reports. In practice this was defined as “the subway test” – could a Member of Congress grasp the essence of the CBO analysis in the time it takes to ride the subway between the House or Senate office buildings and the Capitol?

Tax transparency

209. Beyond ensuring that all taxpayers comply with the law, governments must also address the perceived unfairness of tax policy outcomes. For example, there is a growing perception that governments are losing substantial corporate tax revenue because of tax planning by multinational enterprises (MNEs) that enables MNEs to pay little or no tax by shifting profits in ways that erode the taxable base to locations where they are subject to more favourable tax treatment. Base erosion and profit shifting (BEPS) constitutes a serious risk to tax fairness, tax sovereignty and tax revenues for countries around the globe. If other taxpayers (including ordinary individuals) think that multinational corporations can legally avoid paying income tax it will undermine trust in the tax system and reduce voluntary compliance by all taxpayers—upon which modern tax administration depends. As such, an effort to improve the transparency of the tax system would build trust among citizens that policies and policy outcomes are fair.

Fairness and integrity: a level playing field for all

210. Integrity is a crucial determinant of trust. Comparative evidence suggests a link between trust in politicians, both from the business community and citizens, and the perception of corruption. Integrity tools and mechanisms, aimed at preventing corruption and fostering high standards of behaviour, help to reinforce the credibility and legitimacy of the actors involved in policy decision making, safeguarding the public interest and restoring a sense of fairness of policy decisions. Policy tools addressing high-risk areas at the intersection of the public and private sectors, including effective management of conflict of interests, high standards of behaviour in the public sector, and adequate lobbying and political finance regulation, can be leveraged to limit undue influence and build safeguards to protect the public interest.

Managing conflict of interest: assuring decision-making in the public interest

211. Defining an effective policy approach to dealing with conflict of interest is essential to the political, administrative and legal structure of a country's public life. The OECD Guidelines for Managing

Conflict of Interest in the Public Sector adopted by the OECD Council in 2003 provide a modern approach to conflict-of-interest policy which seeks to strike a balance, by:

- Identifying risks to the integrity of public organisations and public officials;
- Prohibiting specific unacceptable forms of private interest;
- Making public organisations and individual officials aware of the circumstances in which conflicts can arise;
- Ensuring that effective procedures are deployed for the identification, disclosure, management, and promotion of the appropriate resolution of conflict-of-interest situations.

212. The majority of OECD countries have policies to manage conflict of interest according to the OECD Survey on Conflict of Interest (2012). At the institutional level, 76% of OECD countries have a central function responsible for the development and maintenance of the conflict-of-interest policies, rules or procedures. Great importance is placed in most OECD countries on raising awareness and understanding of the policies surrounding potential conflict of interest. For example, in 97% of OECD countries, the conflict of interest policy is disseminated to public officials taking office and/or when they take on a new post. Some limitations remain. While disclosure of private interests by public officials is a common practice, information is only partially made available to the public in the majority of the OECD countries. This is in part due to the importance assigned to privacy concerns. Regarding effective implementation, only 24% of OECD countries employ diagnostic tools, such as surveys, statistical data, and cost-benefit analysis, to measure the impact of the policy, rules and procedures to monitor the effective management of conflict of interest. Measuring compliance also remains a challenge, and while in the majority of OECD countries sanctions are foreseen in the event of a conflict-of-interest violation, there is no data available on how sanctions are applied. Likewise, information on disclosures by decision makers in the three branches of government is only partially made available to the public.

213. In addition, the “revolving door” phenomenon, involving an increased movement of staff between the public and private sectors, has raised concerns over pre- and post-public employment conditions and its negative effects on trust in the public sector. Such issues of impropriety (i.e. the misuse of “insider information”, position and contacts) have led more and more countries to modernise arrangements to effectively prevent and manage conflict of interest in pre- and post-public employment. To balance conflicting interests, many countries have established standards or principles in order to ensure integrity in present or post-public officials. For example, a “cooling-off” period exists in many OECD countries, where public servants must limit their interaction with their former organisation for a given length of time. The *OECD Post-Public Employment Principles* and the *Post-Public Employment Good Practice Framework* (Box A3.4) can act as a reference point for policy-makers to gauge their current or future post-public employment frameworks.

Box A3.4. Managing post-employment conflict of interest: Good Practice Framework

1. The post-public employment system contains the instrument(s) needed to deal effectively with its current and anticipated post-public employment problems and emerging concerns.
2. The post-public employment instrument(s) is (are) linked, where feasible, with instrument(s) dealing with conflict of interest in the public sector and with the overall values and integrity framework.
3. The post-public employment system covers all of the entities for which post-public employment is a real or potential problem, and meets the distinctive needs of each entity.
4. The post-public employment system covers all of the important risk areas for post-public employment conflict of interest.
5. The restrictions, in particular the length of time limits imposed on the activities of former public officials, are proportionate to the gravity of the post-public employment conflict of interest threat that the officials pose.

6. The restrictions and prohibitions contained in the post-public employment system are effectively communicated to all affected parties.

7. The authorities, procedures and criteria for making approval decisions in individual post-public employment cases, as well as for appeals against these decisions, are transparent and effective.

8. The enforcement sanctions for post-public employment offences are clear and proportional, and are timely, consistently and equitably applied.

9. The effectiveness of the policies and practices contained in each post-public employment system is assessed regularly and, where appropriate, is updated and adjusted to emerging concerns.

Source: OECD 2010.

Lobbying as a way of informing public decision-making: Balancing benefits and risks

214. Private interests seeking to influence government decisions, legislation or the award of contracts, through lobbying, is part of the policy-making processes in modern democracies. Lobbying can contribute to good decision making and improve governments' understanding of policy issues by providing valuable insights and data as part of open consultation processes. Yet, lobbying can also lead to unfair advantages for vocal, specific interests when the process lacks transparency and accountability. For example, regulatory failure linked to the political influence of the financial industry through lobbying has been argued to have been a key contributor to the global financial crisis (Igan, 2011).

215. The evidence suggests a rising number of lobbyists and spending on lobbying activities. For example, almost 5 000 lobbyists are registered at the European Commission and Parliament (up from 2 000 registered lobbyists in 2009) and there are an estimated 15 000 lobbyists active in Brussels. In the United States, spending on lobbying more than doubled between 1998 and 2011, increasing from USD 1.44 billion to USD 3.30 billion. This reality calls for enhanced openness and transparency in the process of policy-making, and adequate regulation of interest representation.

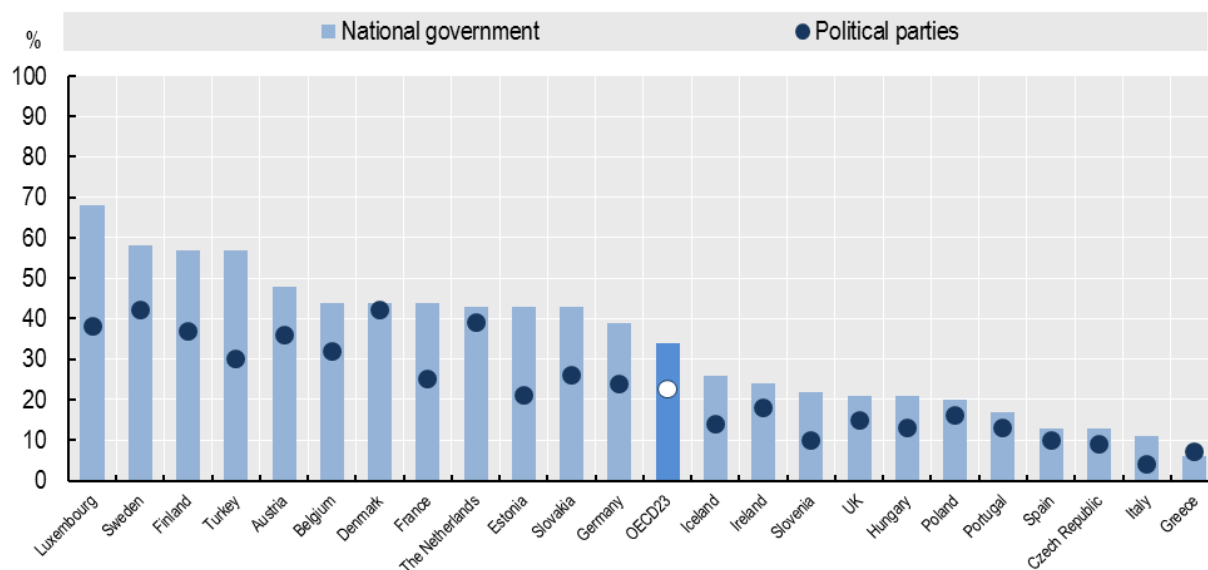
216. In this regard, the 2010 OECD Principles for Transparency and Integrity in Lobbying provide guidance to decision-makers on how to promote good governance in lobbying. The report, currently being conducted, of progress in their implementation, will help guide future efforts to promote a level field by businesses, public officials and lobbyists.

Financing Democracy: squaring the circle of trust, transparency and public interest

217. Money is a necessary component of democratic processes, enabling elections for representation and facilitating democratic competition. To fulfil this enabling purpose, the risks of money in politics need to be properly identified and mitigated. For example, unequal access to funding can distort the level playing field between political parties or candidates, jeopardising democratic competition, while important donations, responding to specific and vested interests, may influence decision making once a candidate is in office.

218. The distrust between citizens and their political parties is alarming. According to the Transparency International Europe Barometer 2010/11, almost 50 % of respondents view their political parties as corrupt or extremely corrupt (except in Switzerland, Norway, Netherlands and Denmark where this percentage is under 30%). Available time series data show a sustained decrease of trust in political parties across European members of the OECD between 2005 and 2012 (OECD, 2013) (Figure A3.3).

Figure A3.3. Trust in government and trust in political parties, 2012, in 23 European OECD countries



Note: Trust in national government: % of “tend to trust” answers to the question: I would like to ask you a question about how much trust you have in certain institutions. For each of the following institutions, please tell me if you tend to trust it or tend not to trust it?

Trust in political parties: % of “tend to trust” answers to the question: I would like to ask you a question about how much trust you have in certain institutions. For each of the following institutions, please tell me if you tend to trust it or tend not to trust it? Political parties.

Source: Eurobarometer

219. Governments recognise this challenge and have mobilised efforts at the national and international level. In the international arena some concrete initiatives were adopted over a decade ago to lay down initial principles to guide the regulation of political finance, including (i) the Council of Europe 2003 Recommendation on Common Rules against Corruption in the Funding of Political Parties and Electoral Campaigns, (ii) the Council of Europe Venice Commission 2001 Guidelines on the Financing of Political Parties and (iii) the 2004 United Nations Convention against Corruption (UNCAC). National regulations have followed, aiming to promote fair competition between political parties and/or candidates by i) balancing sources of funding, ii) introducing bans and limits on certain types of donations, iii) limiting spending during elections, iv) introducing reporting and transparency requirements, v) defining monitoring and enforcement mechanisms of political finance regulations (Box A3.5).

Box A3.5. Summary of major trends and key challenges in regulating political finance in the past decade

A) Balancing sources of funding to promote fair competition:

- 1. Increasing public funding** to promote a level playing field between political parties and reduce their dependence on private funding. While different institutional models have been adopted by OECD countries to manage the allocation of direct and indirect public funds, the purpose is to give parties equal access to financial and non-financial state support. This support could either be a direct transfer, access to specific state services (e.g. airtime in state media, transport, and government property) and tax exemptions. Almost all OECD countries provide public funding to their parties or candidates, however they face a growing challenge in adequately valuing these in-kind contributions and ensuring a level playing field between parties in this regard.
- 2. Regulating private funding** to avoid prejudice to the activities of political parties and ensure the independence of political parties. Certain types of private contributions have been banned in most OECD countries including donations from a) foreign states or companies, b) public authorities including state-owned enterprises, and c) anonymous sources. Regulating private funding remains however a very complex matter as it generates controversial debates on the policy objective that should prevail (e.g. freedom of speech versus protecting the public interest).

- B) Setting limits on expenditures to reduce the dependency of parties on private contributions:** setting spending limits for parties or candidates during electoral campaigns contributes to reducing the overall cost of election thus limiting risks of undue influence which result from strong dependency on private contributions. However new ways to circumvent regulations emerged as regulatory loopholes were not addressed (e.g. using membership fees to conceal donations, or rely heavily on loans and consequently on credit institutions).
- C) Promoting transparency and accountability of all actors in political financing:**
1. Addressing **privileged access to State resources** by elected officials. State resources can be used by incumbent parties to fund their electoral campaigns, it can also be used by elected officials, once in office, to “return the favour” or retaliate against private contributors. A growing number of countries introduced in their political finance regulations bans and limits on the use of different types of state resources. However a comprehensive approach to limiting privileged access to state resources is yet to be defined by countries.
 2. **Promoting transparency in political parties and candidates accounts** by keeping records of donations and campaign expenditures and disclosing them to specific monitoring authorities and to the wider public.
- D) Strengthening monitoring and enforcement of political finance regulations:**
1. **Establishing a single independent supervisory body** to ensure the enforcement of political finance regulation. Although there is no one-size-fits all model, international standards recognised the need for parties and candidates to disclose their expenditure and income related to electoral campaign to an independent entity. Experiences in OECD countries show that this entity needs to be given the necessary financial and human resources to effectively undertake its mission. Additionally its independence from the executive and legislative branches needs to be secured to avoid risks of conflict of interest.
 2. In the absence of **independent supervisory body**, countries are invited, at the least, to have their accounts certified by independent experts. In parallel, political parties in OECD countries are increasingly strengthening **internal audits** within the parties to promote good management of funds and limit risks.
 3. Defining **effective, proportional and dissuasive sanctions**. Experiences show that countries need to ensure the right balance in sanctioning infringements to political finance regulations to ensure that sanctions are proportionate and dissuasive.

220. Regardless of the particular mechanisms chosen, democratic countries face similar risks when addressing money in politics. Weaknesses in enforcement, such as under declaration of contributions or expenditures, as well as inadequate capacity of electoral management bodies, and common loopholes in regulations, such as third party financing or in kind contributions to override controls, highlight that further work to identify good practices and lessons learned to provide comparative evidence and guidance for developing effective framework for transparency and accountability in the realm of political finance is still needed. In addition, experience shows the limits of looking at political finance from a silo perspective, isolating events (e.g. campaigns) without looking at it as dynamic process whose effects can be felt before, during and after campaigns. Rather, looking forward, a preventive approach to political finance regulation that addresses its complexity and leverages transparency as an anchoring element will facilitate better assessment of risks and vulnerabilities and the identification of tailored preventive measures aligned with the realities of differing arrangements, actors and functions of government. A better understanding of the economic implications of political finance is another area where the OECD could contribute.

Trust in practice: towards inclusive policy making

221. An overarching priority for governments should be to build a policy making process conducive to trust. In particular, the economic crisis sparked a debate on the role of governance failures and regulatory capture in the crisis. Concerns over the undue influence of vested interests over decision making has led to increasing demands for more transparency and a greater commitment to safeguarding the public interest. Efforts to guarantee that the policy making process is open, inclusive and fair would not only send a clear signal that governments have learned the lessons of the recent past, but would also improve the quality of policy decisions.

222. It is vital that governments provide sufficient assurance that the broader public interest will be respected and that a level playing field for businesses and citizens will be ensured in the policy making process. While there is significant differences in the way that public policy decisions are made in different countries, from the role of their legislature to the nature of political parties, the credibility of the formal institutions involved in policy making can shape stakeholder's trust in the legitimacy and functioning of the decision making process. As such, our analysis of trust in government must also try to understand how the decision making processes themselves influence trust.

223. A policy-making process conducive to trust is built on reliable and relevant information, provides a clear information exchange structure, and effectively articulates the expectations of different actors. The following core elements can be identified:

- The Policy Making Process is informed: two aspects can be considered in this regard (i) the inclusiveness of the information available to decision makers, to ensure that it facilitates participation and representation of all the actors with a stake in the policy problem at hand; and (ii) the quality of the information available to decision makers, associated with mechanisms such as evaluation, and performance management.
- The Policy Making Process is aligned with the Public Interest: the ability of the policy making process to safeguard the public interest and avoid capture, while effectively aggregating competing, but often legitimate interests. The recognition and effective regulation of formal mechanisms to influence policy decision making, including lobbying or support to political parties can help strike the right institutional balance.
- The Policy Making Process is aligned with broader principles and high standards of behaviour: studies show that a crucial determinant of trust in government is whether government can be expected to take the right decisions and safeguard the public interest without the need for scrutiny. Integrity tools and mechanisms, embedded within a solid integrity framework to prevent corruption and foster high standards of behaviour, are necessary to reinforce the credibility and legitimacy of the actors involved in policy decision making.

224. These core elements can help governments identify policy levers to influence the nature of the policy making process, in a manner consistent with their own specific institutional contexts. **New and traditional policy tools** can be leveraged to effectively mitigate risks of undue influence or capture of the decision making process while rendering it more open and inclusive. Table A3.1 suggests a schema by which policy makers can understand the links between policy objectives and the practical policy levers that can help achieve these objectives.

Table A3.1. Policy Levers for Trust in the Policy Making Process

| Policy Objective | Guiding Elements | Policy Levers | |
|---|---|--|--|
| The Policy Making Process is well informed | Inclusiveness of the information and views relevant to the specific policy problem available to decision makers; Quality and reliability of the information available; | Access to Information Citizen engagement Open Government Ex ante and ex post evaluation, performance budgeting, regulatory impact assessment. | Openness and Citizen Engagement |
| The Policy Making Process is aligned with the Public Interest | Ability of the policy making process to safeguard the public interest and avoid capture, while effectively aggregating competing, but often legitimate interests. | Transparency and Integrity in Lobbying Political Finance regulation | Safeguarding Integrity and Curbing Undue Influence |
| The Policy Making Process is aligned with broader principles and standards of ethical behaviour | Integrity framework, aimed at preventing corruption and fostering high standards of behaviour, thus reinforcing good policy making. | Conflict of Interest management Codes of Conduct Transparency of the policy making process | |

225. Moving from an approach that focuses principally on policy measures (the “what”) to one that understands better “how” policies are designed and implemented will help strengthen institutions and in turn promote greater trust between citizens and government.

226. Looking forward, the OECD can help countries to strengthen trust in the policy making process, systematising knowledge in areas that have already been explored by the OECD, like lobbying, conflict of interest and consultation, while closing the remaining gaps in others. The OECD can support better implementation and enforcement of regulatory frameworks to curb undue influence in decision making, while understanding the interaction of key policy levers (e.g. open government, conflict of interest, lobbying and political finance) with each other and with the policy making process. In addition, the scope of OECD work in this area should go beyond central government and take into consideration the particularities of different levels of government (e.g. sub-national) and sectors (e.g. financial sector).

227. The OECD, in cooperation with other international bodies, can build on the results of ongoing activities in key areas relating to trust in the policymaking process. This might include: reporting on progress made in implementing the 2010 OECD Recommendation on Integrity and Transparency in Lobbying; analytical work on open government for inclusive and responsive policy making (including cooperation with the Open Government Partnership); and analytical work on financing democracy, to

provide guidance on how to build an effective framework that, in particular, leverages transparency as a key tool for enforcement, accountability and informed voting.

228. Across all activities, it will be particularly important to ensure a dynamic approach to these policy levers that allows a better understanding of the complex interaction and complementarities between them and with economic and social policies more broadly in order to achieve inclusive policy making that is conducive to trust.

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