

Averting a Human Crisis During the Global Downturn

Policy Options from the World Bank's
Human Development Network



CONFERENCE EDITION

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Foreword

These are extraordinarily challenging times for the global economy. The downturn has taken a wrecking ball to the growth and development gains of the world's poorest countries. Global GDP growth, after a robust eight-year stretch, is now set to shrink by 1.7% this year—an historic contraction with world output set to decline for the first time since World War II. This global economic crisis will have long-term implications for developing and middle-income countries, and their social and economic prospects.

Consequently, this compendium of crisis policy papers from the World Bank's Human Development Network poses a number of key questions. Are there lessons from recent crises to help us protect people's physical and social well-being during these highly uncertain times? What can governments do to safeguard their human gains of previous decades? How severe will the crisis be and how long will the current crisis last? How can the international development community best mobilize to help developing and middle-income countries weather the crisis? And how can countries and their development partners use the crisis as an opportunity to expand access to quality health, education, social protection and other key services which are vital to developing country efforts to achieve the 2015 Millennium Development Goals?

We have better evidence of how previous crises affected human development in middle-income countries than in lower income countries. However, we can expect to see a repeat of some developments from previous crises to emerge in both middle and low-income countries. For example, we know already that households are experiencing unemployment and reduced earnings and other income. This in turn is affecting the nutritional value of the food people eat as poor households are often forced to switch from more expensive to cheaper, less nutritious food, resulting in weight loss and severe malnutrition, particularly in children. Less household income also makes them less likely to seek medical attention when they fall sick. Children are being forced to drop out of school either to supplement the household income or because their parents can no longer afford school fees or travel.

Many people are at risk of falling into extreme poverty when catastrophic health events coincide with people losing their jobs and livelihoods. People especially vulnerable to the impact of the financial downturn include people living with disabilities, ‘informal’ workers who toil in the shadows of the mainstream job market and make up a large percentage of the workforce in developing countries, and poor women and children (especially mothers and girls) because of gender discrimination.

In fact, it has been shown that in developing countries experiencing economic contractions of 10% or higher, more than 1 million excess infant deaths may have occurred during 1980–2004.

The value of pension fund assets is also severely affected in an international economic crisis. Losses in asset values over the last 12 months reported by pension funds have been considerable, with losses in funded systems of client countries ranging from 8% to 50%. However, abrupt policy changes in response to the immediate circumstances should be avoided. It is important to note that only a small number of retiring individuals are affected by the crisis, so targeted measures are needed to mitigate the losses in their savings and the value of their pensions.

Moreover, since pension systems are designed to function over long time periods, poorly designed short-term responses can potentially have negative effects. Diversified multi-pillar pension systems, and increased attention to managing short-term risks, are crucial to limit the impact of financial volatility.

Social services are likely to suffer as governments cut back on spending, currencies devalue, and external aid donors come under pressure to maintain existing levels of foreign assistance. Poor countries with weaker fiscal positions will suffer the sharpest effect of this crisis. Yet, these are the very same countries that will most need sustained investments in their people’s knowledge and productive skills in order to recover more quickly from economic losses due to the crisis.

The lessons of previous crises can show us how to protect health and education outcomes while reducing financial risk. One powerful lesson is that general strategies to maintain government social spending have often failed to protect

poor people's access to essential social services during financial emergencies and ended up helping better-off groups in society instead. More accurate targeting of social benefits and subsidies will therefore be vital to helping poor and vulnerable groups weather the crisis and get the help they need.

Social safety net programs can also produce immediate relief and, in concert with protection of the budget for key services, they can also help to safeguard the education, health, and nutrition outcomes that contribute to medium-term growth.

We also know that active labor market programs such as public works, job and skills training can play a crucial role to spur employment during the crisis and in the aftermath.

It will also be important to ensure supplies of essential health commodities in the face of worsening exchange rates. Conditional cash transfers and other incentives may also help to maintain access to health, education, and other social services during the crisis and beyond. At the national level, low-income countries may need specific short-term measures to protect their progress to date on the Millennium Development Goals (MDGs).

The following papers offer a number of potentially useful policy options to help governments and their development partners safeguard human development gains as they navigate their way safely through the crisis. We expect to build on this work over the coming months as we learn more about the impacts of the current global crisis.

—Joy Phumaphi

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Key Policy Recommendations

Education

- ❑ Demand-side programs in education can cushion the worst effects of the economic crisis. Some of the most effective programs include conditional cash transfers, school feeding programs, and student fellowships.
- ❑ Supply-side interventions such as block grants to schools in the most vulnerable areas, on-time payment of teacher salaries, and incentives for teachers to be present in their classrooms help ensure that students stay in school and learn.
- ❑ The crisis presents opportunities for education sector reforms that increase efficiencies which can offset some of the effects of diminished resources. Priorities should include measures to ensure that allocated resources do reach schools, increase the accountability of schools and improve teacher performance.
- ❑ Monitoring the impact of the crisis on government spending, households and schools will be important for shaping an appropriate and adaptive policy response, as the effects of the crisis on education will be different across countries and within countries and economic recovery may be slow.

Health, Nutrition and Population

- ❑ Maintaining pre-crisis levels of government expenditures on health as a proportion of total government spending is desirable, but by itself does not guarantee that pro-poor services will be protected. Governments should take explicit measures to protect pro-poor expenditures on health.
- ❑ Public spending should target adequate nutrition for the most vulnerable groups, as a fall in the quantity and quality of nutrition is one of the most serious human development consequences of an economic crisis.

- ❑ Low-cost social insurance programs and other financial protection measures can be extremely cost effective in reaching the poor during an economic crisis.

HIV/AIDS Treatment and Prevention

- ❑ A more rigorous and determined push for efficiency and cost-effectiveness helps countries better prioritize resource allocations across HIV/AIDS treatment and prevention programs.
- ❑ For countries with high reliance on external financing for AIDS programs, national authorities and their development partners should identify impending cash flow interruptions and provide bridge financing that, at the very least, prevents treatment interruptions.
- ❑ A simple early warning system can help track and minimize treatment interruptions, including better monitoring of drug supplies and use of key health services.
- ❑ For countries receiving emergency budget support, an appropriate base level of funding for HIV should be included as part of the social protection package.

Social Safety Nets, Labor Markets and Pensions

- ❑ To strengthen safety net systems to respond to current and future crises, three key steps are required: augment fiscal space from donor resources and seek efficiency improvements; promote inter-governmental coordination; and improve capacity building and knowledge sharing.
- ❑ Labor market responses to the crisis should complement financial stabilization and macroeconomic measures and should focus on the most vulnerable groups. Middle-income countries should consider expanding and enhancing income support programs like unemployment insurance, while low-income countries should use public works programs, especially in rural and isolated areas.
- ❑ Policymakers should move away from ad hoc implementation of individual programs toward a comprehensive package of training, income support, internship and re-employment services to address the multiple challenges workers will be facing in a period of crisis.

- ❑ Abrupt policy changes for pension systems should be avoided, as poorly designed short-term responses can have negative long-term consequences on the capacity of pension systems to reliably provide adequate levels of retirement income. Since only a small number of retiring individuals are affected by the crisis, targeted measures can be considered to mitigate the losses in their savings and value of their pensions.
- ❑ The current crisis strengthens the need for diversified multi-pillar pension systems which allow for a better diversification of risks and better protection to individuals who may be most vulnerable to the economic shocks. To strengthen the management of exposure of individuals to short-term financial risks in funded systems, measures include default portfolios designed for workers near retirement age, and the development of phased transitions to the payout of benefits.

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Education

Safeguarding Education During Economic Crisis

SUMMARY

Developing countries have made significant gains in improving education outcomes. The last 15 years have seen sustained progress towards reaching the MDGs with the number of children out of school falling by 24.2%. For example, primary completion rates in Sub-Saharan Africa rose from 51% to 60% between 1990 and 2007, while in South Asia they rose from 62% to 81%.

But the current global economic downturn threatens this progress—by reducing the ability of both households and governments to invest in education. The crisis could lead to spending cuts if governments cannot find additional financing in the event that private capital inflows and domestic fiscal revenues drop sharply. Teacher salaries may be delayed and public money for school repairs and school inputs may be greatly reduced. At the same time, revenues from parents, the community, and remittances from abroad are falling as family incomes falter, making schools even more dependent on transfers from the government. Children and young people may be pressed to drop out of school to work more hours at home or take on outside jobs.

Deteriorating enrollments and learning levels during the crisis could cost developing countries a competitive head-start when the global economy recovers. Those countries that are able to maintain or build up the skills of their work force during the recession will be poised to take advantage of opportunities once the recovery starts. Wealthy countries such as the U.S. are proposing to use growth stimulus spending to support skills development programs, taking advantage of the contraction in jobs to retool laid-off workers and young people for the future. Both low-income and middle-income countries in the developing world should do the same.

School enrollments are at risk, especially in the case of poorer countries and households. The long-term education costs of the crisis occur when young children do not go to school, current students drop out early, or schools cannot deliver good quality instruction. Once students drop out for longer than 12 months, it proves extremely difficult to coax them back. Even without the current crisis, students from poor families, ethnic minority groups, and girls are most vulnerable to pressures to leave school as a result of the crisis.

To sustain educational progress despite the crisis, developing countries and donor countries will need to prioritize efforts and investments. Developing countries should prioritize by (1) sustaining the level of investments where the returns are greatest, and (2) protecting the most vulnerable and disadvantaged parts of the population. Where cutbacks in education spending are necessary, governments should consider carefully which types of education expenditures are the most critical to maintaining the health of the education system. Programs to protect the most vulnerable students should be a priority because, possessing fewer resources, they are more likely to leave school than other students, and it will be much more costly to educate them later, after months or years outside the schooling system.

Donor countries will need to maintain aid levels and improve aid effectiveness. Aid levels depend on the income levels and political support for aid in donor countries. Past banking crises, for example, have led to sharp declines in aid. But reducing development aid at this time could be very costly, especially to countries which are striving to achieve their education goals during this period of economic crisis. Donors must honor their aid commitments while allocating aid in ways that are most effective in advancing educational development.

Identifying the nature and magnitude of the impact of the crisis in the education sector is an important first step to developing an appropriate crisis response. Field reports indicate that the crisis is affecting some developing countries more than others. Thus, the ability to monitor changes in indicators that relate to student enrollment, dropout, and absenteeism rates, on the one hand, and to service delivery (e.g., delays in teacher pay, availability of school supplies, and school closures) on the other, is critical for prioritizing the responses in the education sector.

Demand-and supply-side programs can cushion the worst effects of the crisis

- ❑ **Conditional cash transfer programs (CCT)** in several countries have been shown to be an effective way to encourage poor households to invest in their children's education. When incomes fall and such transfers are in even greater demand, CCT programs can help keep children in school.
- ❑ **School feeding programs** are an important safety net that not only keeps students in school but also enables them to focus on learning tasks, especially in places where poverty routinely forces students to come to school hungry.
- ❑ **Student fellowships** can help prevent a large exodus from private schools to public schools of students who can no longer afford the fees. Such large transfers can overcrowd public schools and reduce their quality, and close down much-needed private schools in underserved communities.
- ❑ **Block grants to schools** are already being used to improve the quality of schools while giving the school community a greater say in how these resources are used. At the very least, these grants ensure that students have continuing access to schools that are equipped with teachers and supplies. They could be critical to the survival of schools that are likely to see a significant decline in non-salary allocations.
- ❑ **Teacher salaries** account for the bulk of education spending in all countries, and thus are vulnerable to cuts and extraordinary delays during tight fiscal conditions. While governments may have to adopt fiscal austerity measures, putting undue burden of such measures on teachers would demoralize them, increase absenteeism, and erode the quality of instruction and learning. Ensuring that teachers are paid on time and that they are present in their classrooms, however, is an important means to ensure that students stay in school and that they learn.

Despite the risks to educational progress, the crisis may offer some longer-term opportunities as well. The crisis may create opportunities for undertaking reforms to improve the performance of the education system over the long term. More stringent fiscal constraints at all levels of the system provide the rationale and potentially also the political support for tightening oversight of budget and procurement processes. Adequate resources are essential for attaining education goals, but the efficiency with which these resources are used also matters. By implementing **reforms that increase efficiencies**—

and monitoring the gains in efficiency from those reforms—countries can offset some of the effects of diminished resources.

Promising initiatives could include also measures to increase the accountability of schools and improve teacher performance. In a weak labor market, it may be easier to attract better candidates into the teacher force and to compel current teachers to upgrade their skills. Teachers may be more willing to consider reforms that base part of their progression, promotions, or pay on measures of performance, rather than simply on factors like tenure and credentials that are at best weakly related to student outcomes. Training programs could be designed in a way that allows workers to draw on them in times of need to support just-in-time skill upgrading or return to school.

ACHIEVEMENTS AT RISK

In the past decade, developing countries have made significant gains in expanding educational opportunity, as a result of greater attention to education by governments and civil society and an increase in international support. They have moved closer to the goal of universal primary education (MDG 2): the net enrollment rate rose from 80% in 1990 to 83.2% in 2001 and to 86.4% in 2006, and the number of children out of school fell by 24.2%. Some countries have turned greater attention to quality as well, and there is some evidence that these efforts are paying off. Several developing countries have recorded significant gains in learning outcomes. Jordan is one example. Between the 1999 Third International Mathematics and Science Study (TIMSS) and the 2003 TIMSS, Jordan improved its science score by 0.25 standard deviations, which is equivalent to about a whole year of learning. Jordan continued to improve, and in 2007 surpassed several countries which had a similar or slightly higher performance in 1999. Similarly, Indonesia recorded significant improvement in learning where its Program for International Student Assessment (PISA) test score in mathematics increased by 30 points, or 0.3 of a standard deviation, between 2000 and 2006.

As a result of the crisis, these significant education achievements of the past decade are at risk. It is likely that the crisis will weaken governments' and

donors' ability to sustain this progress. Moreover, the scale of the remaining challenge is great. By 2006, 75 million children were still out of school, 55% of them girls. Given that education has long-term payoffs, rather than short-term gains, it may be tempting to cut back on education; that, however, would be short-sighted and would ultimately result in serious declines in future output. The remainder of this note describes expected impacts of the crisis on education and evidence of how governments and donors can respond.

HOW THE CRISIS COULD AFFECT THE EDUCATION SECTOR

Effects on the demand side

The main effect of the crisis is a substantial temporary reduction in overall production and in income levels. This might affect public and private investments and demand for education in the short-term, at high societal and economic costs in the long-term, as students that drop out may not enroll again or may not be able to recover from learning gaps due to inability to attend school. It is anticipated that the crisis will have effects at the household level, the school level, and the system level. Not all of these effects will necessarily reduce enrollment, but all will put severe strains on the education systems.

With declining household incomes, direct and indirect costs for education become a heavier burden. Where students incur some direct schooling costs, however small, poorer students may have to forego schooling. Moreover, the pressure for more household members to earn income may increase demand for children and youth to substitute for adult home production, and for youth to find work outside the home. These effects could reduce school attendance, driving down student performance and increasing dropout rates.

At the same time, the decrease in paid work opportunities may reduce the opportunity cost of attending school and thus increase the likelihood that youth will stay in school longer. For instance, at the higher education level, it has been estimated that the U.S. recessions during 1968–1988 were responsible for increasing U.S. college enrollment rates by almost 400,000 students. Two major recessions in Mexico, in 1982–83 and 1986, have been associated with higher school retention and continuation rates. In addition to decreasing opportunity costs, a

sustained contraction of the economy sends a message that there are no jobs and so the return to education is lower. On the one hand, this signal could lead to a discouragement effect; on the other hand, the contraction could mean that only the most educated would have any chance of finding a job.

Not all households will be affected to the same extent. There will be heterogeneity in the impact of the economic crisis on education, so country context matters in formulating a policy response. In Indonesia in the 1997–98 crisis for example, urban households were more severely affected than rural households in terms of unemployment, earnings, and also school enrollment, because the crisis entailed a devaluation that boosted incomes in rural areas relative to incomes in urban areas. In the current crisis, distributional impacts will likely vary along numerous dimensions, including geographical location and age. For instance, poor households with younger children in Indonesia were most likely to be affected by the crisis in terms of education spending and enrollments.

At the tertiary education level, there could be a decline in the resources available to students to pay tuition and other costs, and hence a decrease in student demand, especially in fee-based institutions. This could lead current students to drop out and new students to postpone or forgo entry. The crisis could lead to tighter credit markets, which mean that households (and schools) will have fewer ways to buffer themselves, and students, especially in universities, may not be able to obtain student loans necessary to stay enrolled. Following the economic crisis of 1998 and 1999, government austerity measures led to Malaysian universities reducing their operating and development expenses by 18%; and reductions in corporate and public donations and on returns on investments from capital markets led to the corporatization of some educational institutions. State higher education institutions experienced expansions in enrollment between 1997 and 1999, largely driven by the return of students studying abroad and a drop in private enrollment by 20 to 30%. In Korea, the reduction in educational expenses in response to the crisis varied according to the socio-economic level of the families: While the richest 20% increased the share of education expenditures by 0.8 percentage points; the rest of the socioeconomic distribution reduced this share by 0.02–.05 points.

Effects on the supply side

At the school level, with declining household incomes, revenues from fees are likely to fall, making schools even more dependent on transfers from the central and/or local government. Lower fiscal revenues could mean that schools may not receive their usual budgetary allocation for operations; allocations for operations and utilities, repair and maintenance, and school supplies are likely to be the most vulnerable to cuts. Lower fiscal revenues could also jeopardize fellowships for students. Teachers' pay may be delayed; because teacher salaries comprise the largest share of education budgets, this is a common result when a country's fiscal situation is tight. To supplement declining household incomes, teachers themselves may feel greater pressure to earn extra income, driving up the rate of moonlighting and absenteeism, thus reducing the quality of instruction. For example, in Laos it is the teachers whose salaries are not paid on time who tend to offer tutoring services for pay.

Another impact could be a sizeable shift of students from private to public schools, given a decline of available resources to pay tuition and other schooling fees. Assuming that aggregate demand for education does not shrink, a fall in households' ability to pay for private schooling may lead students in private schools to transfer to public schools. If public expenditure on education remains constant or declines, the impact on the public school system would be to raise pupil-teacher ratios, to increase the pressure on often insufficient or inappropriate infrastructure, and to compromise learning quality.

The impact on private schools would also be adverse. Even if few students shifted from private to public schools, private schools would find it much harder to raise funds through tuition fees and may be forced to freeze their fees for significant periods for time. As a result, these schools would be in a weak position to sustain or improve the quality of their services. The experience of the Philippines is instructive. Between 1982 and 2006, the share of secondary enrollments in private schools fell dramatically, from 46% to 20%, reflecting the outcome of the introduction of free public schooling. The secondary school system is now performing worse than before, with severe over-crowding in public schools and a much weakened ability of private schools to raise revenues through fees for their operations.

Lower fiscal revenues overall could mean budget cuts and lower spending across sectors. The effect would be stalling new construction of classrooms and schools, reducing repair and maintenance activities, and postponement of new hires. On the one hand, budget cuts would mean pressure to cut administrative costs, including school supervision and the implementation of reforms; on the other hand, sustained budget cuts could exert enough pressure to formulate and implement reforms that decrease fat in the system and present opportunities to increase its efficiency. In any event, developing countries' demand for and reliance on international assistance is likely to increase in order to sustain investments in human development as their GDP growth declines by 3.3% in 2009.

Reductions in international donor assistance would further exacerbate the negative impact of an already tight fiscal situation. There is a danger that deep recession and fiscal pressures in developed countries could translate into weaker voter support for aid and hence reduced levels of donor assistance. New research estimates that over the past quarter-century, each increase of 1% in donor-country GDP per capita has been associated with an increase of aid of at least 1 to 2%. If this relationship holds in times of economic downturn as well, overall aid levels could decrease substantially as donor-country incomes fall several percentage points below their trend in 2009 and 2010. The effect on aid could be greater still because of the economic crises, given the experience of OECD countries that sharply reduced their aid outflows following domestic economic crisis in the 1990s. Any aid reductions would weaken governments' overall fiscal positions.

EVIDENCE OF THE EFFECTS OF PAST CRISES ON EDUCATION OUTCOMES

Past economic crises have had countervailing effects on enrollments. Loss of income may reduce household demand for education because out-of-pocket expenditures will be a heavier burden in relative terms, but at the same time a decrease in the opportunity costs of education due to weak labor markets may increase enrollment. Whatever the net effects on enrollments, reductions in government, household and donor budgets for education are likely to threaten educational investments and worsen education quality and learning outcomes.

Effects on enrollment were mixed, with the negative effects concentrated in poor countries and households. The balance between substitution and income effects determines actual short-term impacts of the crisis and helps explain heterogeneous impacts across countries, in particular, whether education indicators will improve or worsen. Evidence from Indonesia following the crisis in the late 1990s indicates that the urban households were more severely affected than rural households in terms of unemployment and earnings. As a result, education expenditures per age-eligible household member (age 5–20) declined more in the urban sector than in the rural sector. On the other hand, the education shares in household budgets declined by over 10% in urban areas and by nearly 30% in rural areas. Spending reductions were particularly marked in poor households with more young children (10–14 years). Poor households with older children (15–19-year-olds) tended to protect education spending. In turn, the economic crisis had a negative effect on enrollments of younger children. In 1998 there were 35% more out-of-school 10-year-old boys than would have been the case had the rate of rising enrollments between 1993 and 1997 had not been disrupted.

Similar findings about unequal impact emerge from Latin America. There is little indication that school enrollments systematically declined during past aggregate economic crises, reflecting the heterogeneity of responses to crisis. In Mexico and Nicaragua there were marked increases in enrollment, and in Peru and Brazil enrollment increases were marginal, while in Costa Rica school enrollment patterns were pro-cyclical, meaning that there were reductions in enrollment. In Peru, the crisis of the 1980s was expected to reduce enrollment, given the declines of almost 50% in household and public incomes, but in fact the probability of being enrolled increased as a result of a reduction in the opportunity cost of schooling.

In Sub-Saharan Africa, the evidence suggests that the current crisis will almost certainly have an adverse effect on enrollments and may even reverse recent progress toward the elusive goal of universal primary school completion. In an exhaustive study of growth acceleration and deceleration in the region over the past 30 years, the findings show that an asymmetric relationship exists between education (and other indicators of human development) and growth. Primary school completion rates are substantially lower in countries

experiencing growth decelerations, and they are negatively correlated with growth collapses.

Learning is likely to suffer, as dwindling resources put pressure on school quality. While there is no rigorous systematic evidence that shows direct impacts on the quality of teaching and learning following a financial shock, it is likely that it suffers. One channel for this deterioration is its effect on teacher performance, such as through greater absenteeism. Several recent studies in contexts as diverse as India, Indonesia, the United States, and Zambia indicate that frequent teacher absences reduce student learning, in some cases, by substantial amounts.

For example, in Zambia, teacher absence driven in part by AIDS and other illnesses has sharply reduced learning, as measured by math and English tests: each increase in teacher absence of 5% leads to decline in student learning by 4–8% of an average year's learning. A detailed study of Peru found that the prolonged economic crisis of the 1980s eroded school quality and almost certainly retarded learning, with 70% of children from the poorest half of the poverty distribution not being able to read. These findings highlight the potentially large effect of declining school-level inputs on student learning and thus the importance of protecting them in times of crisis.

Crises do less harm to better educated workers. Better educated workers are more able to sustain earning and consumption levels during an economic downturn because they are generally more able to adapt to the changing demands of the labor market and to the use of new technologies, and they are more able to use information to find jobs or other sources of income during the recovery. Less educated workers—as well as minorities and women—are more likely to suffer from a crisis because they have fewer skills and may be less able to retool themselves. In the long run, they are also less likely to benefit from the recovery. Supporting evidence comes from the U.S., where more educated workers experienced smaller reductions in the amount of hours worked, annual earnings, and employment rates relative to less educated workers.

In Indonesia educated workers were more likely to retain their jobs relative to less educated ones; and in Mexico and Argentina, less educated workers

experience significant earnings losses. These experiences point to an increase in inequality during and after an economic crisis.

LEARNING FROM PAST CRISES ABOUT APPROPRIATE POLICY RESPONSES

To sustain educational progress despite the crisis, developing countries and donor countries will need to prioritize efforts and investments. This might mean reallocating resources to the most pressing areas—for example ensuring that the poor or vulnerable are able to stay in school, ensuring that teachers are paid, and paid on time, to ensure that they are focused on teaching, or ensuring that schools are able to maintain a minimum level of physical infrastructure in light of declining operational budgets. Irrespective of the context, there will be a need for prioritization and better targeting of interventions to those most severely affected in the face of dwindling public and private resources and shifts in education demand.

The experiences from past crises suggest several priorities for developing an appropriate policy response to the crisis.

Identify the population that will be the hardest hit by the crisis and most likely to cut back on investments in human capital. There will be heterogeneity in the impact of the economic crisis on education, so country context matters in formulating a policy response. At the sector-level, a typical reaction has been to protect potential losers; however, the biggest losers are not always a predictable group. The purpose of a rapid education monitoring system would be to monitor changes in education indicators related to the demand side, such as enrollment, dropout and student absenteeism rates, and to service delivery, such as timeliness of teacher pay, maintenance of schools, availability of supplies, and even school closures. Crucial in this monitoring is an assessment of differential impacts on various population subgroups. Two pertinent challenges are:

- (a) *Are current education data systems able to identify the impact of economic crises in the sector?* Appropriate data tools for just-in-time monitoring of changes in different parts of the education system should be developed. Many countries have education management information systems

(EMIS) in the Ministry of Education, but these systems are generally not designed for monitoring unexpected changes in education indicators during times of crisis. A growing number of developing countries also conduct household surveys, but these surveys tend to be episodic and complex. However, it is potentially valuable to use these two types of data platforms to build a rapid education monitoring system at the school and household levels. The crisis has magnified the need to enhance monitoring and evaluation systems in three main areas: impacts on enrollment and learning; impacts on national and local budgets, and in particular non-salary expenditures; and impacts on aid budgets. The existing data platforms can be used to build a sensible sampling frame for constructing a representative picture of the impact of the crisis. They also provide valuable baseline information against which to compare current indicator levels.

- (b) *Is the education system able to feed back critical information to policymakers for the purpose of formulating an appropriate response to crises?* Just-in-time data collection should lead to just-in-time policy analyses and timely feedback to policymakers. The link between data collection policy analysis and policymaking is often a tenuous one, but one that needs to be strengthened in order to shape effective responses to the current crisis. Improving capacity for informed policymaking is not an action that sparks excitement as an adequate response to emergency situations, but a sound foundation for policymaking is more important than ever when resources are scarcer.

Target resources to more vulnerable populations. To the extent that there is an impact, it is likely that the poor—and the near-poor—will suffer most. Studies of Indonesia and Latin American countries show that in response to crisis, families below, or close to, the poverty line were more likely than wealthier ones to reduce investments in human development. Policies to supplement resources for schooling should therefore be targeted to poor and lower-middle income households—and those made vulnerable as a result of the economic downturn.

Invest in demand-side financing programs, such as conditional cash transfers and scholarships, to mitigate the impact of the crisis. Social safety nets are likely to diminish the adverse impacts of crisis on investments on educa-

tion. These findings are consistent with other research that shows that CCTs in Colombia and Mexico have been effective in preventing poor households from reducing investments in education. Evidence from *Oportunidades* in Mexico suggest that the probability of entering secondary school increased by 33% for participating students, that children who stayed in the program for an average of 5.5 years achieved one more year of schooling, and that tertiary school enrollment doubled.

Also operating on the demand side, **student fellowships** could help prevent large enrollment shifts from private schools to public schools and the adverse impacts these shifts might have on school supply. Indeed, these shifts could entail overcrowding in the public sector and loss of revenue in the private sector—with potentially lower quality in both. Student fellowships could be a less expensive alternative than large investments in school infrastructure. Especially if targeted to poorer students, student fellowships have been shown to increase net enrollment in lower-income neighborhoods without overcrowding public schools by using existing capacity in private schools. Evidence from a recent public subsidy program targeted at low-cost private schools in Pakistan shows a significant increase in the number of students enrolled, teachers employed, and school infrastructure, without any significant increase in student-teacher ratio or student-classroom ratio.

In addition to encouraging school attendance, **school feeding programs** improve child health and nutrition—which in turn have substantial positive impacts on cognitive development, particularly for the poorest and most vulnerable children. Evidence shows that health interventions have large positive impacts on cognitive development with effect sizes ranging between 0.7 and 0.8 of a standard deviation. The social shocks associated with the global food, fuel and economic crises have given new prominence to such programs. In many low-income countries, there is already evidence about the design and impact of these school feeding programs. For instance, providing breakfast to malnourished children in Jamaica improved their scores in cognitive tests by 0.25 of a standard deviation. If disseminated well, such knowledge would promote policy dialogue at the country level about these programs and thus increase uptake of new funding facilities and the likelihood of better results.

Increase supply side investments. A prolonged economic downturn weakens the fiscal capacity of countries that are most affected, putting pressure on governments to look for expenditures to cut. Because of diminished fiscal resources, school conditions are likely to deteriorate, weakening the positive effects that demand-side interventions might have. Supply-side programs that are focused on schools can protect education quality.

Schools are vulnerable in that the allocations for repair and maintenance of buildings, furniture and equipment, already too little in many developing countries, could be reduced or frozen altogether. When this kind of situation persists for long, even public schools are tempted to initiate mechanisms for raising funds from students and the community, including the imposition of tuition fees. Such initiatives are likely to reduce enrollments, especially in poorer communities. For these reasons, it would be important to provide supplementary financial grants to supporting schools at risk in the areas hit hardest by the crisis.

Block grants to schools are an approach to easing financial constraints that negatively affect quality of learning, in particular, to support public schools that experience enrollment increases due to shifts from private schools or as a result of a reduction in the opportunity costs of schooling. In response to the East Asian economic crisis in the late 1990s, the government of Indonesia provided block grants to rural and urban schools that cater to low-income students and requested recipient schools to waive primary level fees in order to prevent a reduction in teacher attendance and overall quality.

Ensuring that teachers are paid on time and that they are present in their classrooms, however, is an important means to ensure that students stay in school and that they learn. Because teacher salaries account for the largest item in the education budget, teachers are vulnerable to extraordinary delays in receiving their pay and even to reductions in their pay. These responses to the crisis are likely to demoralize them, increase absenteeism, and erode the quality of instruction and learning, consequences that may be difficult to turn around after the crisis. Evidence indicates that delays in teacher pay increase their likelihood to seek supplementary sources of income, both within the school (e.g., paid after-school tutoring) and outside the school.

CRISIS OFFERS OPPORTUNITIES FOR REFORM

The crisis may create opportunities to initiate and lock in reforms that will improve the performance of the education sector over the long term.

It would not be the first time that a country took advantage of a crisis situation to reform its education system. During Finland's economic crisis in the early 1990s, significant reforms were undertaken in all sectors, and education was a prime beneficiary.

One potential area for reform is teacher quality. In countries that have had trouble attracting enough qualified teachers, worsening labor market conditions will make teaching more attractive as a profession to higher-quality candidates. If education systems can focus on creating the conditions that will induce these new entrants to remain in the profession even after the crisis, the long-term quality of the system should improve. In countries where teaching already attracts enough qualified applicants but performance is an issue, the focus should be on aligning teacher incentives with education goals. In a weak labor market teachers may be more willing to accept pay structures that base a part of their compensation or progression on performance.

There are likely to be opportunities also for increasing system efficiencies, such as reducing expenditure leakages in the education system through better oversight of budget and procurement processes and through the implementation of sanctions against the most egregious misuse of public resources. In a time of diminished fiscal resources, there is likely to be stronger political support for more responsible management within government.

An economic crisis might also be the time to consider putting in place mechanisms that support skill upgrading of the labor force to guard against future crises and economic downturns. Some countries have experimented with individual learning accounts, and other countries such as Chile and Colombia have individual unemployment accounts. Such programs could be designed in a way that allow workers to draw on them in times of need to support just-in-time skill upgrading or return to school.

Support to education policy makers also should be prioritized in times of crisis. Even in good times, effective policies and programs are difficult to

formulate, partly for lack of information about what works, what doesn't and why. In times of crisis, data not only must be solid, but also must be timely and readily fed back to policymakers and stakeholders alike. Ensuring that knowledge and experience are disseminated quickly and effectively shorten the time to design and implement good policies and programs, thereby helping to reduce the negative impact of the crisis on education for families, students, teachers and schools.

As developing countries identify tailored options for dealing with short-falls in education budgets, they should focus on preserving the programs and policies that have proven most effective in achieving education outcomes. Better monitoring and evaluation will allow governments not only to show results to citizens, but also improve education results over time. Serious impact evaluation should be part of any major aid-financed initiative; donors also need to encourage recipient governments to make monitoring and evaluation an integral part of their domestically financed programs.

CONCLUSION

The potential impacts of the crisis will work through both the demand and supply sides of education systems because household incomes, returns to education, and the level of fiscal resources for education all will be negatively affected. But the nature and magnitude of these impacts are likely to be heterogeneous across countries and also within countries.

Sharper and smarter policy responses are essential in times of diminished resources. The specific country context matters in formulating an appropriate response. It is important to identify which population groups will be hit hardest, and how these groups are likely to respond. Monitoring the educational response to the crisis can be a critical tool for designing effective programs that can mitigate the short-run and long-run consequences.

Governments and aid agencies should give the highest priority to those interventions that alleviate the human impacts of the crisis on the poorest and most vulnerable populations. At the same time, they should not lose sight of those investments that will better equip developing countries to take ad-

vantage of opportunities that arise as the crisis abates. **Sustaining progress on education indicators is one of the most effective means to ensure that these countries are able to participate and contribute to a global economic recovery.**

Health, Nutrition and Population

Protecting Health Services for the Poor during Economic Crises: Lessons from Experience

SUMMARY

This paper reviews the impact of previous economic crises and the impact of the policy measures undertaken in response to these crises on health outcomes and health financing. The paper also reviews the effectiveness of health support provided by the World Bank to countries during previous economic crises. Learning from past experience should lead to improved policy-making during the present crisis.

In previous economic crises, government expenditures on health decline in real per capita terms, as seen in Indonesia, Thailand, Argentina and Russia. Even where health was prioritized within the overall budget, real health spending per capita still fell as overall government expenditures declined. For instance, despite increases in the share of health in government expenditure, government health spending per capita in US dollar terms declined in Argentina from \$399 in 1999 to \$121 in 2002 and in Indonesia from \$8 in 1996 to \$3 in 1998. In many cases, this primarily affected non-salary and investment expenditures, and had a negative impact on the quality of care as access to drugs and other commodities declined in public facilities.

Evidence from previous crises also indicates that during times of fiscal contraction the non-poor may capture a larger share of the benefits of government programs and services than before. Consequently, the poor get disproportionately affected by the economic downturn. In addition, there may be an adverse impact on nutrition outcomes, especially as poor households switch from more expensive to cheaper and often less nutritional foods.

Women and children bear the brunt of the impact on health outcomes during crises, as is shown from past crises in Indonesia (1997), Mexico (1995), Argentina (2000) and Thailand (1997).

The paper suggests that the health impact of the current crisis is likely to be widespread. Devaluations will increase the cost in local currency of imported drugs and medical equipment and diminish the ability of developing country governments to pay for these imports. Brazil, Russia, India and South Africa have already experienced nominal devaluations averaging approximately 38% since peak levels in 2007–2008. In addition, donor funding could decline as a result of the crisis. In 2006, 23 countries had more than 30% of total health expenditure funded by external sources. Heavy reliance on foreign aid and the potential decreases in donor allocations may be detrimental to health expenditure levels in many countries.

However, many countries today have a more favorable fiscal and external situation and better ability to enact countercyclical expenditure policy in the health sector than in previous crises. Increases in deficit spending to finance targeted programs that affect the poor can help to counteract some of the negative impacts of the crisis. Many development banks, including the World Bank and IMF, have made available additional lines of financing as a means to assist developing countries maintain expenditure levels. The Bank's lending in health by the World Bank is expected to triple between FY08 and FY09.

Further, countries may be able to take advantage of the crisis situation to improve targeting of health expenditures. Conditional cash transfer (CCTs) programs have been effective in mitigating the health impact of the crisis. Expanding the coverage and increasing the benefit levels on CCTs has been one of the many responses to economic crises, particularly in Latin America (e.g., *Oportunidades* in Mexico and *Bolsa de Familia* in Brazil).

The paper argues that the fundamental objective of public policy in health during a crisis must be to maintain/improve health and financial protection outcomes. This is not at odds with the potential reduction in health expenditures during a financial crisis as governments struggle with tightening budgets. Past experience shows that some countries took advantage of the

crisis to improve the efficiency of their public health systems and were able to protect those services that are essential to the welfare of the poor. This suggests a combination approach of efficiency improvements, being selective in cutting of certain types of expenditures, and/or income-support mechanisms can allow governments to maintain services that are critical to the most poor and vulnerable. Some examples of this type of thinking would be measures to protect the flow of essential drugs and supplies, assuring the functioning of the more peripheral health care facilities and providers in rural areas, and maintaining physical access through targeted subsidies.

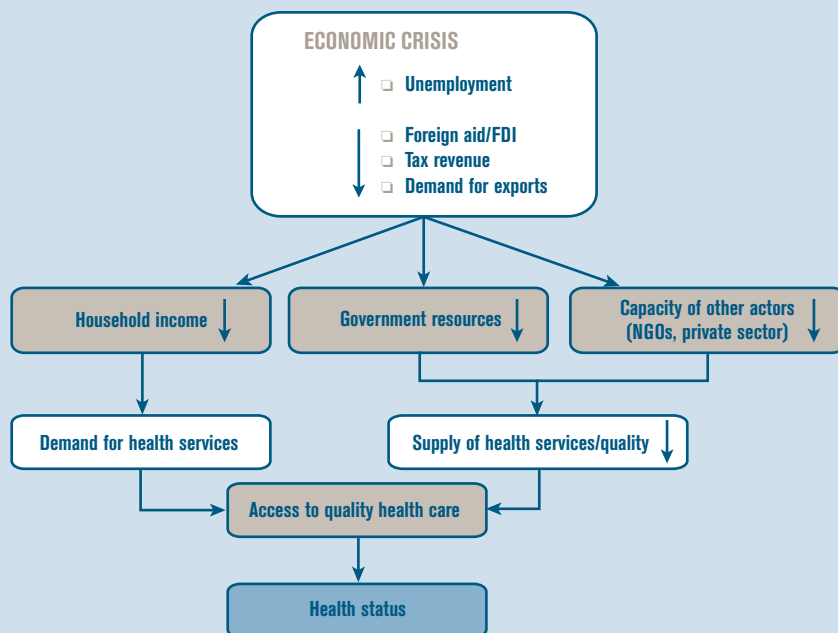
Explicit action should address both health and other sectors that affect health outcomes. Assuring adequate nutritional security for vulnerable groups would be a complementary action outside the health sector. Cash transfers may help improve coverage of both health and non-health sector measures where feasible. Quick disbursing financing mechanisms that could compensate for the price effects of devaluation as well as decreases in foreign aid may be an efficient way for international donors to act quickly and visibly to protect health programs.

A SIMPLE CONCEPTUAL FRAMEWORK

Economic crisis and economic contractions may potentially reduce demand for health services and the supply of quality health services. This could result in reduced access to quality health care for poor people and ultimately a decline in their health status. *While no causality is being attributed in this paper, evidence suggests that there is a strong association between economic downturns, a decline in health utilization, and negative health outcomes in some countries.* Box 1 illustrates one possible schematic of how an economic crisis can impact health status, especially for the poor.

IMPACT OF THE PREVIOUS CRISES ON HEALTH EXPENDITURES

Evidence from previous crises shows that public expenditure, particularly in the social sectors, tends to be pro-cyclical in countries with large fiscal deficits. Governments tend to expand social expenditures during times

BOX 1 From Crisis to Health

Economic crises can have significant negative consequences for health, especially for the poor. Large economic contractions could squeeze public and private resources, thereby impacting the availability of health funding and eventually health outcomes. In particular, poor people are especially susceptible to irreversible damage to their health status as a result of economic contractions. Thus, it is imperative that policymakers, governments and donors be ready with effective policy responses to the prevailing economic crisis.

Increases in unemployment, declining foreign aid/FDI, declining tax revenues, and a lower demand for exports can be expected to result from the current crisis. The crisis is producing job losses across the developing and developed world, remittances are beginning to decline, and a fall in government revenues is expected as tax collections dip. Economic uncertainty may force donors to scale back their aid commitments and for developing countries to reduce social spending. Exchange rate fluctuations may also reduce the purchasing power of aid flows.

Household incomes, government resources, and the economic resource capacity of other actors also tend to decline during any crisis. As economic activity slows down and unemployment rises, both labor and non-labor incomes tend to decline. Poorer households are likely to suffer the most as they have less room to re-adjust and cushion their expenditures, often forcing a decline in demand for health services. Crises can also significantly weaken the public sector and its ability to supply quality health services and delivery

Continued on next page

BOX 1 From Crisis to Health *(Continued)*

of certain services also may be stopped—for instance, budget cuts could force public hospitals to freeze hiring of nurses and doctors. Other significant health providers, including NGOs, who typically attract fewer donors during an economic crisis, may also be forced to cut back service provision.

The aforementioned factors limit individual and household access to quality health care, with a likely impact on health outcomes. The poor people, and other marginalized groups, such as girls and the elderly, are likely to suffer more during crises as they typically have less control over resources. The non-poor and other groups have in the past captured the public sector to the detriment of the poor. Even if outcomes do not change much in the aggregate, it is likely that the health status of the poor and other marginalized groups will regress if preemptive measures are not taken.

of economic expansion and decrease them during recession. For instance, in Mexico the 4.9% fall in GDP per capita between 1994 and 1996 was mirrored by a 23.7% fall in targeted spending per poor person.¹ During times when the population is suffering due to stagnant or decreasing economic growth, social spending on health and education, including certain safety net programs, is at risk of being cut.

Data from Argentina during the 1980s and 1990s highlights this point. In that particular case, elasticity of social spending with respect to total government spending from 1980 to 1997 was 2.14 and statistically significant.² Therefore, a 1% decrease in total government spending is—on average—mirrored by a 2.14% decline in social spending. Conversely, the elasticity of social spending to total spending during times of fiscal expansion was 0.14 and was not statistically significant. Thus, it is critical to look separately at the elasticity of social spending during recessions and expansions. During times of macroeconomic shocks and negative GDP growth,

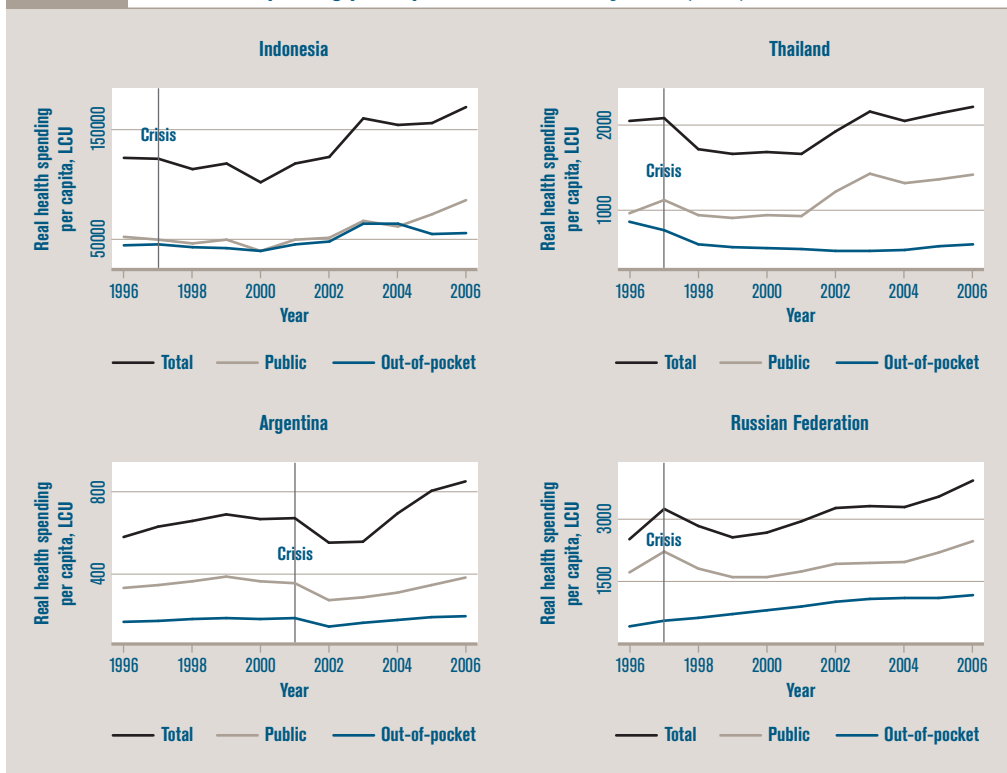
¹ Targeted social spending includes government spending aimed at establishing or strengthening systems of social protection that mitigate the potential impact of crises before they occur and assist the poor cope with the shocks after they have happened.

² Social spending includes education, health, water and sewage, housing and urban development, social assistance, and labor programs.

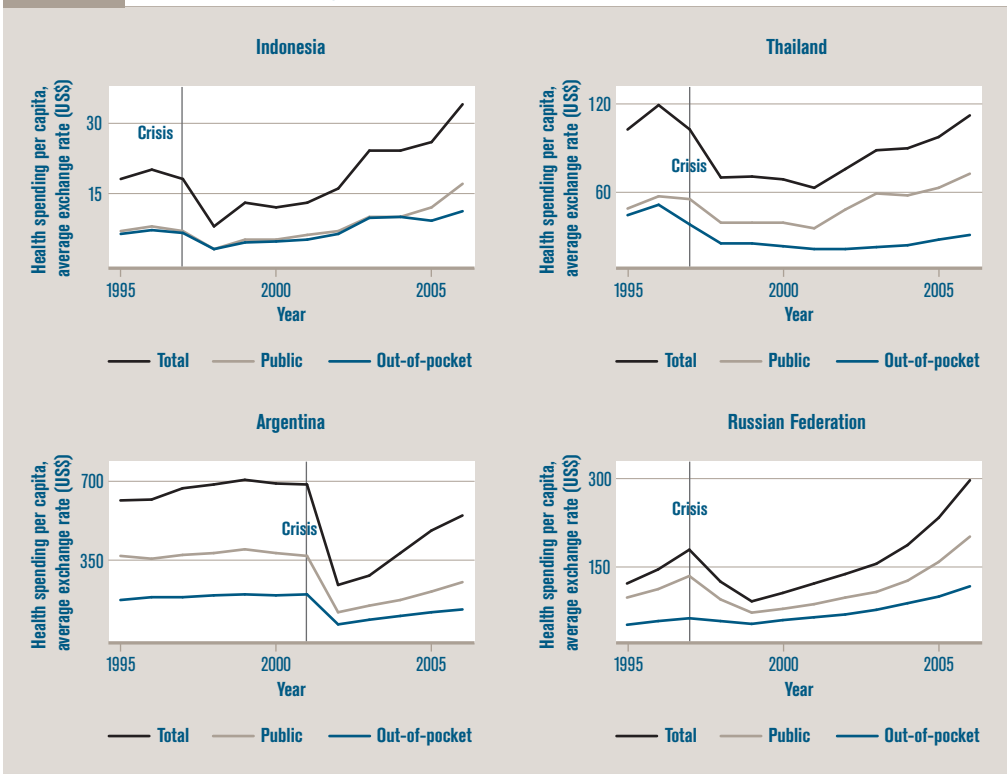
expansionary fiscal policy can help to compensate for declines in income through public spending, especially for vulnerable portions of the population. However, between 1994 and 1996, targeted social spending in Mexico and Argentina actually contracted, concurrently with declines in GDP.

There is evidence that Argentina was able to reverse some of its procyclical social spending trends during the 2001 economic crisis. While total government health spending per capita contracted in real terms and the total government budget contracted by 25% (Figures 1 and 2), national spending on public health programs actually expanded by 70% in real terms—from \$90 million pesos in 2001 to \$150 million pesos in 2002. These increases were particularly focused on strengthening maternal and child health programs and programs targeted at specific diseases, including vaccinations. The

FIGURE 1 Real Health Spending per Capita in Local Currency Units (LCUs), 1996–2006



Source: World Health Organization and World Bank.

FIGURE 2 Real Health Spending per Capita in US\$, 1996–2006

Source: World Health Organization and World Bank.

Government of Argentina effectively prioritized this targeted health spending, despite overall fiscal and economic contractions.

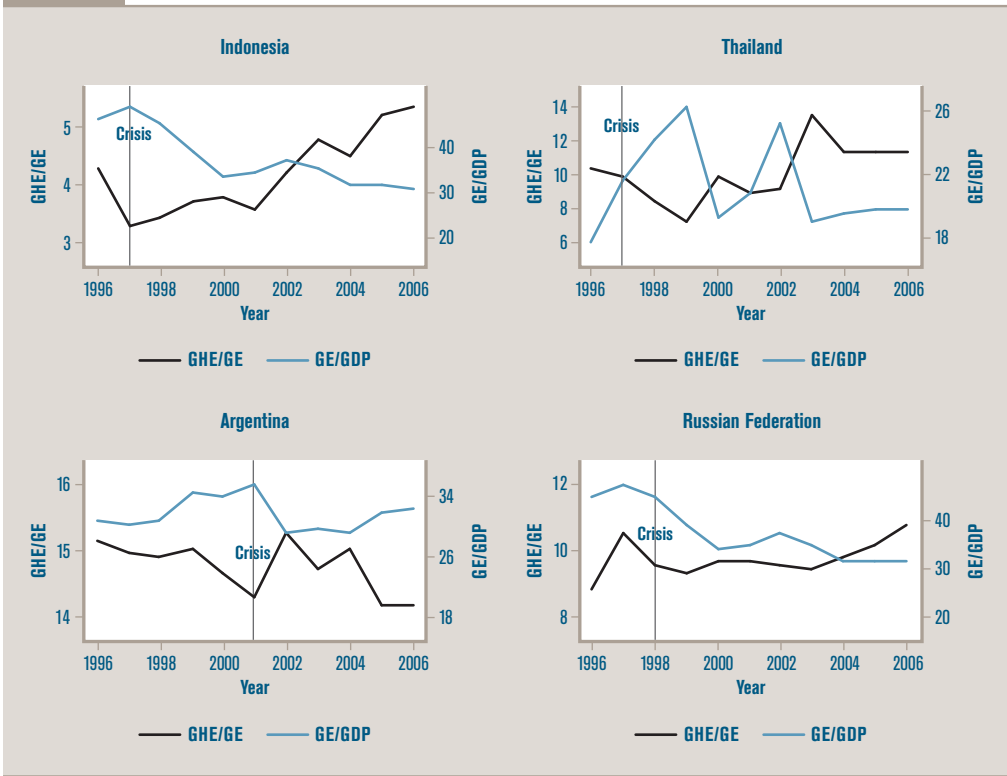
Evidence from previous crises in Thailand, Indonesia, Argentina and Russia highlights the pro-cyclical declines in health spending in both real local currency units (LCUs) and at the average US Dollar exchange rate (the latter highlights the impact of the sharp devaluations that take place during a crisis) (see Figures 1 and 2). Total, out-of-pocket, and public health spending per capita fell in real LCUs, and fell at a much sharper rate in US Dollar terms than in LCUs. In the case of Indonesia, Thailand, and Russia, it took many years for health spending to reach pre-crisis levels again. In the case of Argentina, total and public health spending per capita have yet to reach pre-crisis levels in US Dollar terms. Devaluations result in a rise in prices in local cur-

rencies of imported commodities, including drugs. Declines in government and out-of-pocket expenditure rates, combined with the increased utilization and demand for government services discussed later in this paper, emphasize the squeezing effect these crises can have on the financing of health service delivery. As a result, households may spend less of their income on health and other social services and look to publicly funded and provided sources. In all four of these country cases, the decreases in real public health spending per capita also inhibited the ability of governments to provide health services.

In response to the economic crisis in 1999, the Government of Georgia tried to maintain spending on health at 7.3% of the total government budget, as part of its lending agreement with the Bank. Not only did government health spending decline in real terms that same year, it also did not meet the 7.3% target, according to WHO data.

Evidence suggests that efforts to protect government health expenditure as a proportion of GDP, or as a proportion of total government expenditure, may not be sufficient, as government expenditures per capita in real terms may still decline substantially. In Argentina and Indonesia, despite increases in the share of health in government expenditure (Figure 3), government health spending per capita declined due to a fall in both GDP and overall government expenditure as a percentage of GDP. The decline in government health spending per capita in Thailand was driven by the decrease in health's share of government expenditure and an overall GDP decline. The situation in Russia was particularly severe, with government expenditure as a percent of GDP and government health expenditure as a percent of overall government expenditure both declining.

Non-salary expenditures may see the sharpest declines. In many countries a large proportion of government health expenditure goes to pay salaries. Given the difficulty in downsizing the civil service, non-salary expenditures, used to pay for drugs and other variable inputs, as well as investments, may decline substantially and impact the quality of health care. During the 1997 East Asian economic crisis, the percentage of the Thailand Ministry of Public Health budget going to salaries increased from approximately 39% in 1995, to 47% in 1999. In the Thai case, the investment portion of the health budget fell from approximately 39% of total health expendi-

FIGURE 3 Government Health Expenditure as Percent of Government Expenditure

Source: World Health Organization.

Note: Government health expenditure as percent of government expenditure = (GHE/GE); Government expenditure as percent of GDP = (GE/GDP).

ture in 1995 to 11.5% in 1999. Even if health workers are protected, the quality of health care will decline in the absence of critical inputs such as equipment and medicines, and may be further exacerbated if the price of imported drugs and other supplies increase due to currency devaluation. Subsequent to the 1997/98 economic crisis in Indonesia, the decrease in utilization of health services was more pronounced for public facilities than for their private counterparts, primarily as a result of the severe shortage of drugs and other medical supplies in public facilities and the detrimental impact on quality of care.

Increased reliance on Health ODA in recent years puts poor countries at greater risk of impact from the current crisis. In 1996, only 7 countries received development assistance for health comprising 30% or

more of total health expenditure. By 2006, this number had grown to 23. Currently, in Rwanda and Ethiopia, over 50% of total government-budgeted health expenditure is financed by donors, and off-budget donor funding for health accounts for more than 100% of government health expenditures. While these large increases in external assistance for health have allowed governments to expand service provision, this has also made many countries dependent on these flows in order to sustain expenditure levels and service delivery to their populations, especially the poor and most vulnerable.

Governments need to put into place safeguards to protect health expenditures in real terms, particularly for those services and programs utilized by poor and most vulnerable populations. In Argentina, during 1980–1998, the targeting of social programs aimed at the poor weakened as the non-poor captured benefits. The *Trabajar* program was designed as a workfare program intended to help compensate poor unemployed workers from the impact of macroeconomic shock. When the health budget expanded, so did the presence of *Trabajar* in poor areas.³ However, during times of fiscal contraction, the program was cut from poor areas. As the budget was cut, the non-poor effectively captured the benefits of the program. However, social programs from Argentina, Bangladesh and India, show that that targeting tends to improve as workforce programs expand. For example, workfare component of the *Jefes de Hogar* (Heads of Household) Program⁴ in Argentina addressed some of the weaknesses of earlier programs by expanding coverage and increasing spending on the social safety net. Argentina's response during the 2001–02 is also illustrative of how government protection of priority health programs can protect essential services used by the poor and the most vulnerable. (See Box 2.)

³ An evaluation of the *Trabajar* program, supported by the Bank, found that 80 % of benefits went to people in the bottom 20% of the income distribution, and over half of the benefits reached the lowest 10% (after factoring in foregone incomes).

⁴ A social safety net launched by the Government of Argentina in April 2002 to alleviate the impact of rising unemployment due to the sharp worsening of the economic crisis. The *Jefes de Hogar* Program provides a stipend of 150 Argentine pesos/mo to an unemployed head of a household in exchange for participation in 4 hours of work in community services, small construction or maintenance activities, or training, including finishing basic education, or as a temporary employee of a private company.

BOX 2 Protection of priority health programs in Argentina during and after the 2001–02 crisis

The 2001–02 crisis in Argentina caused a drop in total health spending, but the national government protected spending on priority health programs. National spending on public health programs (including transfers to provinces) increased by 70 % in real terms—from 90 million pesos in 2001 to 150 million pesos in 2002. This increase is largely attributable to the strengthening of the maternal and child health program and the program for preventing and controlling specific diseases and risk factors (which include the purchase of vaccines). Health allocation in 2003 reflected a continued priority accorded to these programs.

Total Health Sector Allocations (including National Public Spending and Budget Transfers)
(In millions of pesos, 2001)

	2001	2002*	2003*
All public health programs	89.19	150.84	121.92
Fight against AIDS and sexually transmitted infections	3.41	1.03	0.24
Prevention and control of diseases and risk factors (including immunizations, VIGA-A, etc)	42.46	100.52	65.86
Maternal and child health care	29.45	40.32	41.84
Coverage for emergency health care	1.26	8.31	13.09
Other programs	12.61	8.31	13.09
Prevention and care of addictions, and the control and fight against drug addiction		7.41	11.39
Diagnosis and treatment of chronic diseases and risk behaviours		5.22	16.42

Source: National Office of Consolidated Public Spending – Ministry of Economy, 2003

* preliminary estimates

Additional evidence confirms that aggregate cuts in social programs tend to be associated with pro-poor targeting and deteriorating benefits. In India, for example, based upon the difference between the average and marginal odds of participation in three key poverty reduction programs—public works schemes, the Integrated Rural Development Program and a food rationing scheme—higher aggregate outlays of various social programs were associated with more pro-poor benefits and conversely, as budgets are cut, the targeting of the programs also deteriorated. The marginal odds of participation tended to fall more steeply than average odds of participation for richer income quintiles, pointing to a capture by the rich of the benefits and a greater vulnerability

of the poor to lose out to budget cuts. Similar results were found in programs in Bangladesh and Indonesia. As allocations were raised, the participation rate for the poor in the program increased faster than for the non-poor. *Thus, policy makers need to be particularly cognizant that as budgets contract, non-poor are likely to capture the benefits of social programs.*

IMPACT OF PREVIOUS CRISES ON HEALTH UTILIZATION AND OUTCOMES

Economic crises often disproportionately impact the ability of the poor to afford health services. This can occur due to a variety of reasons. During economic crises, real wages tend to fall and unemployment tends to rise, driving down labor earnings. Non-labor incomes also fall because of declines in economic activity and changes in the relative prices of the goods and services produced by the poor. Thus, *demand for, and utilization of, health services may experience a decline during periods of economic distress.* Apart from being unable to afford treatment at health facilities and hospitals, the poor may be forced to forego consumption of essential drugs as local currency devaluation results in an unaffordable increase in the price of drugs. During the East Asia crisis, prices of drugs rose significantly in Indonesia, and prices of some generic drugs, which were generally affordable to the poor, rose sharply during 1997–98 with some antibiotics doubling in price.

When government health expenditures decline, the quality of services in public facilities declines, and available services may be captured by the non-poor. Thus, without targeted pro-poor interventions, the poor are disproportionately affected in terms of utilization of health services. For example, in Argentina, from the end of 2001 to the middle of 2002, preventive health care for children dropped 38% in the general population, but 57% in the poorest households.

Economic crises also have a significant adverse impact on nutrition. Poor households are often forced to switch from more expensive to cheaper and often less nutritional foods, resulting in weight loss and severe malnutrition.⁵

⁵ It is estimated that higher food prices in 2008 may have already increased the number of children suffering permanent cognitive and physical injury due to malnutrition by 44 million.

Even though the crisis itself may last for a few years, the impact on maternal and child health may be permanent. Children who experience short-term nutritional deprivations can suffer long-lasting effects including retarded child growth, lower cognitive and learning abilities, lower educational attainment, and lower earnings in adulthood. These problems may be more acute for developing countries, particularly sub-Saharan Africa and lower-income Asian countries, where health outcomes such as infant mortality and malnutrition have been shown to rise as GDP growth declines during recessions.

During the East Asia crisis, a survey of public health facilities in Thailand reported a 22% increase in anemia amongst pregnant women which is suggestive of a switch to less nutritious foods. In Indonesia, prevalence of micro-nutrient deficiencies (especially vitamin A) in children and in women of reproductive age increased during the crisis period. Also, the share of women whose body mass index is below the level at which risks of illness and death increase rose by a quarter, and the average weight of children under age three declined in Indonesia in 1998.

Women and children often bear the brunt of the decline in health services. Most crises tend to affect these groups disproportionately because of their lack of control over resources and gender-based discrimination.⁶ As mentioned earlier, there is some evidence that households have been forced to cut back on both food quantity (caloric intake) and quality (dietary diversity) during a crisis, and girls and women usually suffer more as they are unable to protect the nutrient intake that they particularly need. Mortality of girls may be much more sensitive to changes in economic circumstances than that of boys. One multi-country study reported that *infant girls may experience almost three times higher increased mortality than boys for a given change in per capita GDP*, described by the authors as “a remarkable difference by any standard”.⁷

⁶ Including extensive time burdens; threats or acts of violence; and limited legal benefits and protections, decision-making authority, and control of financial resources.

⁷ The data on births and deaths are based on 123 Demographic and Health Surveys (DHS) covering 59 countries. The surveys include countries in Africa (33 countries, 68 surveys), Latin America (12 countries, 31 surveys), and Asia (14 countries, 27 surveys).

Over 1 million excess deaths (infants) may have occurred in the developing world during 1980–2004 in countries experiencing economic contractions of 10% or higher. While the impact may vary across countries, it appears that crises either result in a worsening of health outcomes for infants and children, or a slowing down of health improvements.

In Latin America, the pace of decline in infant mortality rates decreased in some countries because of the economic crisis during the 1980s. During these crisis years, child mortality increased by an average of 7–10% in Mexico. However, women and children are not the only groups at risk; the young and elderly are also susceptible. For example, mortality rates for the very young and the elderly increased or declined less rapidly in Mexico during the crisis years as compared with non-crisis years. Peru provides further evidence of the impact that crises can have on children. The economic crisis during 1998–02 resulted in a 2.5% point increase in infant mortality, with 18,000 more children dying than in the absence of the crisis. Though causality cannot be proved, the contraction of public health spending may have contributed to the increase in infant mortality.

There is limited evidence that child health outcomes suffer less in countries where expenditure on health is protected. Past crises have resulted in cuts in expenditures on health, lower utilization of health services, and deterioration of child and maternal nutrition and health outcomes. However, it is difficult to establish whether these nutrition and health outcomes deteriorated less in countries that protected health expenditures from cuts, since the counterfactual is largely absent and establishing causality is difficult. Government health expenditures were cut in Indonesia following the 1998 crisis, but the effect of this was somewhat mitigated by increased donor assistance to the health sector. This may have contributed to Indonesia's somewhat better performance in health outcomes, compared to other countries during crisis time. The contrast between Argentina's policy actions after the 1993 crisis, which largely led to protecting non pro-poor expenditures, and the 2001 crisis, with strong protection of expenditures on nutrition, maternal and child services and essential drugs, may help explain some of the improved child and maternal outcomes seen in Argentina after 2002.

The next section discusses the response to previous crises by governments and policymakers to protect vulnerable populations from worsening health outcomes.

RESPONSE TO PREVIOUS CRISES BY GOVERNMENTS AND POLICYMAKERS

Social health insurance programs and social safety nets (SSNs) can serve as effective instruments in protecting health service utilization during crises. In Indonesia, the *Health Care Subsidies (Health Card)* program was an important component of the social safety net, introduced by the government as a response to the economic crisis in 1997. Under this program, a number of services were offered free to card holders, including: (1) outpatient and inpatient care, (2) contraception for women of child bearing age, (3) prenatal care, and (4) birth assistance. While similar schemes already existed at the time, the coverage and scope of the program were changed and expanded as part of the SSN program. The program was part of an overall effort to address the impact of the crisis, which included a rise in the price of items such as food and medicine. It was somewhat effective in increasing the utilization of health services, where direct subsidies were provided for basic health services for the poor. Evidence suggests that while targeting was pro-poor in the distribution of the health card, there was considerable leakage to the non-poor. Utilization of the health card for outpatient care was also pro-poor.

“Crises have given birth to some of the worst social protection policies and some of the best.”

Martin Ravallion, Director, Development Research at the World Bank

The Thai government also expanded existing social insurance programs as a response to the East Asian crisis. As part of this expansion, increased support was provided to the *Public Assistance Scheme* for low-income families. Government subsidy to the *Voluntary Health Card (VHC)* was also doubled from 500 baht to 1,000 baht per card.⁸ Health centers and district hospitals

⁸ Under this scheme, free health cards were distributed to the unemployed and low-income families.

reported a large increase in distribution of free health care cards between 1997 and 1998, and this may have contributed significantly to the increased use of public facilities,⁹ thus mitigating the impact of the crisis on demand for health services by the poor.

Other examples of effective crisis policy interventions include conditional cash transfer (CCT) programs. Expanding the coverage and increasing the benefit levels on CCTs has been one of the many responses to economic crises, particularly in Latin America. Mexico was able to redress the adverse welfare impacts of the recent rise in food prices by implementing a one-time top up payment to *Oportunidades*¹⁰ participants. Payment to the poorest families increased by 24.3% in 2008. While this additional payment did not fully compensate the poor for the increase in food prices, it did help avoid a detrimental effect on the poor¹¹.

CCTs have been an extremely cost effective mechanism for financially constrained governments. On average, safety net expenditures in developing countries crisis fall in the range of 1–2% of GDP, although there is significant variation across countries. Some of the more successful programs such as Mexico's *Oportunidades* or Brazil's *Bolsa Familia*, cost about 0.4% of GDP. However, CCTs are not always responsive to changes in the need for assistance, and can be prone to capture. Thus, it is critical that governments reassess eligibility when a crisis occurs. Finally, CCTs do not, in themselves, improve the supply or quality of services. If vaccines are not available at the health center, the baby will not be vaccinated, even if the CCT encourages the mother to bring the child to the clinic. Thus, demand-side incentives such

⁹ VHCs accounted for two-thirds of the outpatients visiting public health facilities.

¹⁰ During the Tequila economic crisis of 1994, the Government of Mexico realized that it lacked an effective safety net for the country's poor. In 1997, it responded with a program called 'PROGRESA' (later called *Oportunidades*), which was oriented towards the poor and replaced simple cash transfers with subsidies to household investments in human capacity development. It worked more effectively because it relied on the active participation of women to improve their own and their families' education, health, and nutrition status.

¹¹ The number of beneficiaries increased by 1 million and the total number of Mexicans assisted by the program reached 5 million households (one out of four Mexican families) in 2008. Payment to the poorest families also increased to an average of 665 pesos per month (from an average of 535 pesos per month).

as CCTs must be accompanied by adequate access and supply of services to be effective. This is even truer in times of crisis, when budget support for service delivery may be under stress.

Economic crises have been used as an opportunity to improve the efficiency of public health systems. In Thailand, for instance, the MoPH launched the “Good Health at Low Cost” strategy in the post-crisis period. This involved drug management reform (procuring a higher proportion of essential drugs, and support for greater use of generic drugs as currency devaluation increased the relative price of the more expensive patented formulations), and savings from a reduction of operating/capital costs and material costs.¹² As part of the reformulation of the MoPH budget, capital costs were reduced from 38.7% of the total budget in 1997 down to 11.5% in 2000.¹³ At the same time, budgets were protected for essential services and programs such as HIV/AIDS.

Protecting government spending in sectors other than health can complement essential health expenditures. Public works programs have often been used by governments as a safety net. Public spending on labor-intensive public works projects, such as building rural roads, can combine the benefits of an aggregate fiscal stimulus with those of income support for poor groups. Indonesia and Korea introduced such programs during the East Asian economic crisis; as did Mexico in the 1995 peso crisis; Peru during its recession of 1998–2001; and Argentina in the 2002 economic crisis. India has used public works programs to provide safety nets for many years. Research suggests that such programs do provide income gains for participants. Programs like Argentina’s *Trabajar* provide effective household income support and also show that if correct incentives are in place for targeting work to poor areas, such programs may serve to compensate somewhat for what made those areas poor in the first place. *Preventing people from slipping into poverty could be critical in protecting health outcomes.*

¹² This included measures such as reducing expenses on electricity, water and telephone in public hospitals and minimizing capital costs. No new capital investment projects were undertaken in 1998 and 1999 except to complete existing obligations.

¹³ Capital costs were reduced from 38.7 % of the total budget in 1997 down to 27.3 % in 1998, 15.5 % in 1999, and 11.5 % in 2000.

RESPONSE TO PREVIOUS CRISES BY HOUSEHOLDS

During a crisis, households may no longer be able to afford health insurance or may become ineligible. In most developing countries, pension, health, and unemployment insurance systems generally cover only formal sector workers. Thus, only a small proportion of the poor are insured. Layoffs during a crisis may result in a large pool of uninsured individuals. The absence of health insurance, combined with the inability to finance health services through out-of-pocket payments, may result in reduced utilization of health services. For example, a survey from Argentina revealed that one negative consequence of the 2001–02 crisis was that by mid-2002, 13% of households reported that they had canceled their health insurance. The reduction in insurance coverage was three times greater among poor households relative to non-poor households. As a result, 57% of poor households reported a reduction in the utilization of preventative health services by their children.

Users may switch from the private health sector to the public health sector as their ability to pay for health services is impacted. For example, In Thailand, the private sector faced significant demand reductions, and doctors from the private sector turned to the public sector for employment. Increased government support to the *Public Assistance* and *Voluntary Health Card Schemes*, and measures such as a reduction in private hospital entitlements in the Civil Service Medical Benefit Scheme, facilitated a transition to the public health sector. In Argentina, household incomes shrank during the 2001–02 crisis and households modified their demand for health services. By mid-2002, 38% of households reported greater use of public health centers instead of private services.

Households may have to bear additional costs and be forced to reduce their utilization of health services if public health systems are unable to respond because of reduced budgets and increased demand.

WHAT SHOULD DONORS DO? EVIDENCE FROM THE WORLD BANK'S RESPONSE TO PREVIOUS CRISES

The evidence on the effectiveness of Bank support to countries to protect pro-poor health expenditures and health service delivery for poor and

vulnerable populations during economic crises is mixed. The Bank's programmatic lending operations in countries affected by economic crises in the 1990s and 2000s were reviewed in order to assess past experience and derive good practices to support quality health services for the poor during the current economic crisis. We reviewed these loans to see whether loan agreements included support for health expenditures, with an additional focus on whether pro-poor expenditures and services were identified as priorities. We then examined project completion reports to see whether countries met their commitments, and if this translated into actual protection of health services and expenditure levels.

Findings suggest that successful projects financed the initiation or expansion of sustainable safety nets that tied essential health services to identified funding on a per capita basis, along with an appropriate system of monitoring and evaluation. For instance, a primary objective of the 1999 Brazil Social Protection Special Sector Adjustment Loan (BSPSSAL) was to maintain expenditures on basic education, medical care, and nutritional services. Specifically, budget protection in health was included, based on floors set on per capita spending at the state and municipal level for a defined benefit package. Successful projects also avoided placing conditions on short term financial assistance that involved long term institutional reforms (which require an investment or capacity building instrument). Additionally, projects worked better when the Bank supported government efforts to expand the breadth and depth of coverage of an existing safety net, or to introduce a new, more sustainable safety net. This includes the *Bolsa de Familia* in Brazil and the *30-Baht/Universal Coverage* insurance plan in Thailand referenced earlier.

Despite some strong evidence of good practice, better data and measurable indicators. The project data tended to concentrate on the source of financing, rather than analyzing the potential effect of such financing on service delivery, or health outcomes. Likewise, the evaluations focused on indicators such as percentage of government expenditure allocated to health or other social programs which, as we have seen above, may not provide sufficient evidence about the beneficiaries. Few evaluations investigated whether the World Bank was supporting programs that were pro-poor to begin with. *As the World Bank and other donors respond to the current crisis, the focus should*

be to help finance a specific set of services for the poorest and vulnerable people, protect expenditures on a per capita basis and in real terms, and where possible, expand existing, well-targeted and sustainable safety nets. Baseline indicators are needed as the foundation for rigorous post-crisis evaluation.

CONCLUSIONS AND RECOMMENDATIONS

The global economic crisis is impacting almost all developed and developing countries. Slower growth is forecasted for most emerging and developing economies. Developed country economies are contracting and this may impact foreign aid contributions, FDI, remittances, and global trade. Highly donor dependent countries are especially vulnerable to aid cuts. Currency devaluations in developing countries will result in higher domestic prices of imported goods, including drugs. These price increases in local currency units may decrease access to essential medicines, as well as increase the pressure on potentially shrinking government health budgets. The timing of the current crisis, on the heels of the food crisis, puts the poorest and vulnerable populations at even greater risk.

This paper uses country examples from previous crises to highlight the potential negative impacts on health expenditures, health utilization rates and health outcomes. It highlights mechanisms by which economic crises might impact the health sector, provides examples where impacts have been fairly severe, and identifies some effective policy responses. Because this crisis is different from previous crises and because much of the evidence available to us from earlier events relates more to middle-income countries than to the poorest countries, there is a need for more and better evidence and sensitive prospective monitoring going forward.¹⁴

The paper argues that a fundamental objective of health public policy during a crisis is to maintain/improve access to essential services by the population, and especially the poor and vulnerable. This is not at odds with the potential reduction in health expenditures during a economic crisis

¹⁴ New efforts to develop such monitoring and more in-depth country analysis is in the planning phase now in partnership with other development agencies.

as governments struggle with tightening budgets. Past experience shows that some countries took advantage of the crisis to improve the efficiency of their public health systems and were able to protect those services that are essential to the welfare of the poor. Thus, a combination of efficiency improvements, being selective in cutting of certain types of expenditures, and/or income-support mechanisms can allow governments to maintain services that are critical to the most poor and vulnerable.

Previous crises in Asia and Latin America show the negative impact that crises can have on access to health and nutrition services and health outcomes. Women and children are especially vulnerable. During crises, households may demand fewer health services and opt for lower quality and quantity of nutrition. Government capacity is also impacted. This may result in deteriorating health outcomes, especially marked in the poorest quintiles of the population.

During past crises, the Bank has supported operations that attempted to protect public “pro-poor” expenditures through loan and credit agreements. The experience has been mixed. *Good practices include* avoiding conditions in short term lending instruments that involve long term institutional reforms. *Projects worked better when they:* (i) were aimed at financing a specific set of services that are used by the by poor/vulnerable, (ii) protected expenditures on a per capita basis and in real terms rather than only ratios such as percent of GDP, or government expenditure, (iii) financed expansion of existing safety nets, or facilitated introduction of a sustainable and well targeted safety net with clearly defined beneficiary populations, and (iv) supported appropriate monitoring and evaluation mechanisms. *Experience suggests that certain policies should not be supported:* (i) general input or commodity subsidies; (ii) general conditions that earmark expenditures for the whole sector; (iii) conditions that only protect expenditures without identifying the services, or the target population to be protected; and (iv) conditions that protect financing or services that are not pro-poor in the first place.

While maintaining government health expenditures as a proportion of total government expenditure may be a worthwhile objective, it does not guarantee that pro-poor services will be protected. Real government health expenditures per capita declined in all the reviewed countries

immediately after the crisis. This decline occurred even as many countries tried to protect government health expenditures as a proportion of total government expenditures. *Development partners need therefore to focus on protecting pro-poor health expenditures, rather than overall expenditures.* Interventions that boost household income so as to enable the poor to maintain access to essential health services may also be an option if mechanisms are in place to manage such expenditures. Evidence suggests that if well designed, low-cost social insurance programs and CCTs can be successful in reaching the poor with minimum leakage, and can also be extremely cost effective.

Given that the fall in the quantity and quality of nutrition is one of the most serious human development consequences of an economic crisis, pro-poor expenditures must focus specifically on ensuring adequate nutrition. Pro-poor public spending on health, education and social protection will need to be protected to ensure that nutrition related outcomes and other health-related outcomes do not deteriorate.

Global Crisis and HIV/AIDS Treatment – Vulnerabilities and Impact

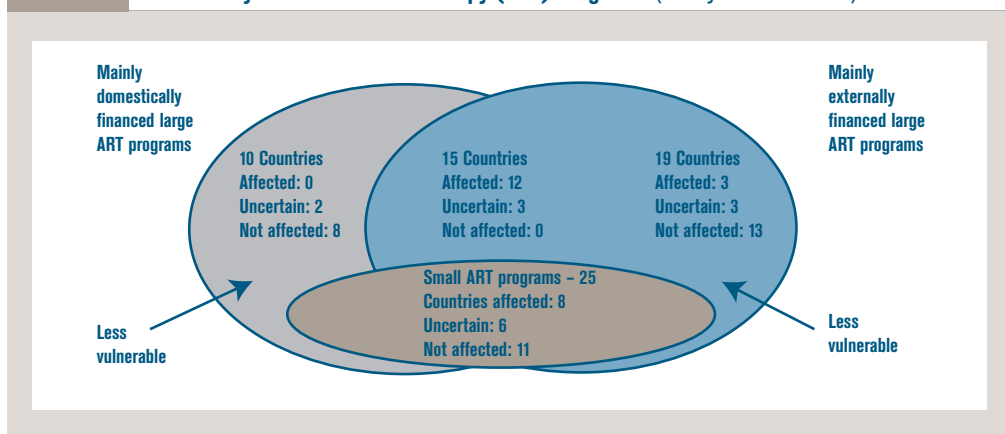
OVERVIEW

What is the effect of the crisis on the global HIV epidemic, especially in high-prevalence countries? What are the possible consequences? What can be done? Information collected in late March 2009 from 69 countries (in which 3.4 million people are on treatment)¹⁵ and our growing understanding of AIDS treatment shows that:

¹⁵ This note draws heavily on ongoing collaborative work by the World Bank, UNAIDS and WHO which will be released soon in a joint publication. Information was collected by agency representatives working closely with the National AIDS authorities in 69 low- and middle-income countries, which together include most people on treatment in the developing world. Preliminary conclusions are referenced here for consideration at the 2009 IMF-World Bank Spring Meetings in Washington DC.

- ❑ **In 2009, the global crisis is expected to negatively impact AIDS treatment programs in one-third of countries surveyed—home to 61% of those on antiretroviral treatment. Much is at risk:** treatment that is keeping 3.4 million people alive and healthy; the plans and global promises to expand access to the other two-thirds of all people with HIV who urgently need treatment now (whose numbers grow daily); and efforts to further reduce the number of new infections, now 2.7 million each year.
- ❑ **Stopping treatment is deadly, and has other costs on society.**

 - If treatment stops, people quite soon become sick and die. Countries know all too well the desperate consequences for households (children orphaned, loss of human capital, increased household poverty), and the costs to businesses and public agencies that lose skilled, experienced staff.
 - People who stop treatment become far more infectious.
 - Disrupted treatment diminishes drug effectiveness, requiring use of extremely costly second-line drugs and placing additional demands on health systems to monitor their use.
- ❑ **Impact varies across regions,** and is most likely in Sub-Saharan Africa, and also in Eastern and Central Europe, the Caribbean, and Asia and the Pacific.
- ❑ **Declines in external funding and budget cuts would leave people in 15 developing countries highly exposed to the risk of treatment interruption** (Figure 4). There are 1.7 million people on treatment in these countries—and far more who also need treatment.
- ❑ **The health sector will come under additional stress.** Interruptions or cuts in treatment will result in more people with HIV-related illnesses. The demands on health systems would be exacerbated if doctors and nurses lose access to treatment. Reduced household incomes may push more patients towards public health services at a time when their budgets are being cut.
- ❑ **Prevention efforts are jeopardized: 34 countries representing 75% of the people with HIV expect prevention programs for people most at risk of infection to be affected.** This is extremely worrisome—less prevention that results in more new infections will mean greater future treatment needs and large cost increases. The welfare and economic costs to affected families are obviously very high.

FIGURE 4 Vulnerability of Antiretroviral Therapy (ART) Programs (survey of 69 countries)

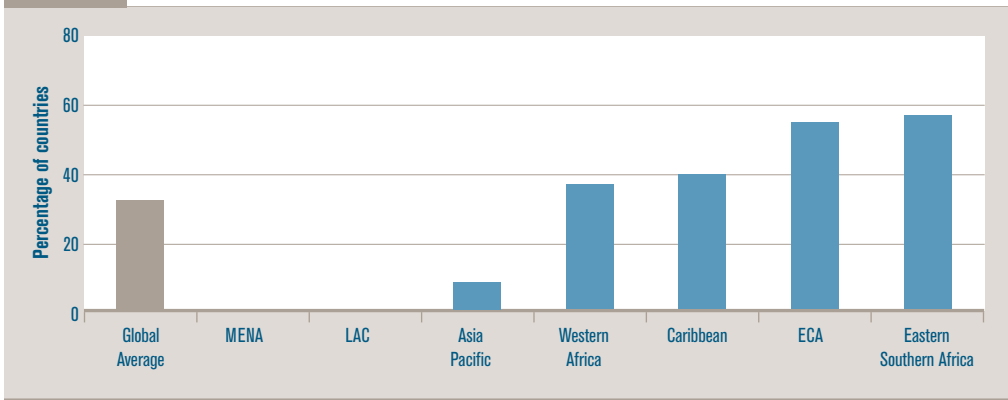
Source: World Bank/UNAIDS/WHO Survey of 69 countries.

- **The core challenge is to maintain and expand access to HIV treatment and prevention.** This requires:
 - A more rigorous push for efficiency and cost-effectiveness. Development partners can assist countries to better prioritize resource allocation across prevention and treatment programs. Evidence-informed, results-driven programs will be more efficient and effective.
 - Donor “safety net” funding to ensure continued access to drugs and other supplies;
 - Assisting countries to strengthen their ability to forecast future drug demand;
 - Establishing a monitoring system to track and minimize treatment interruptions.

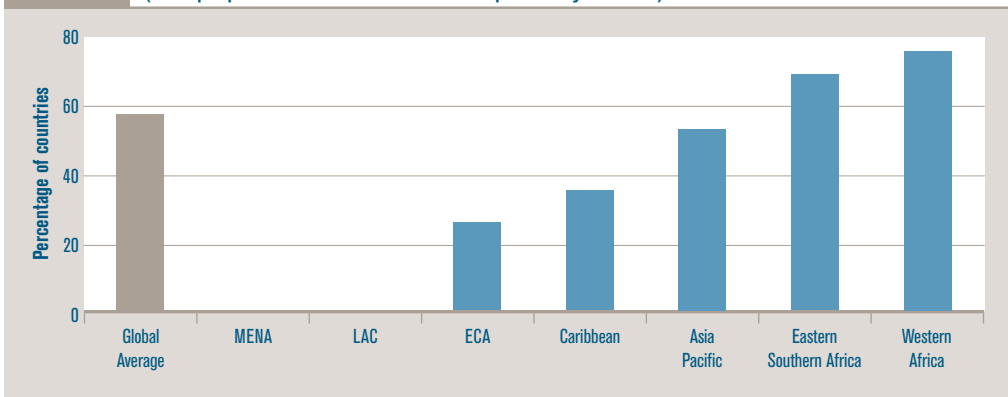
VULNERABILITY OF TREATMENT PROGRAMS

Countries expect the effects of the crisis on AIDS treatment programs to worsen over the year. While only nine of 69 countries surveyed report that there has already been an impact on treatment, 33% of countries (Figure 5)—home to 61% of people on treatment (Figure 6) expect some impact over the year, with concern highest in Sub-Saharan Africa.

Differences across regions are pronounced. Countries in **North Africa** and the **Middle East** have few people on antiretroviral treatment, economies that

FIGURE 5 Adverse Impact Expected in the Next Twelve Months (% of countries)

Source: World Bank/UNAIDS/WHO Survey of 69 countries.

FIGURE 6 Adverse Impact Expected in the Next Twelve Months (% of people on treatment who could be potentially affected)

Source: World Bank/UNAIDS/WHO Survey of 69 countries.

have been less affected by the economic crisis, and greater fiscal space, and report no impact on AIDS treatment programs. Latin American countries also report no impact on treatment so far and few expect any impact in the coming year. Although affected by the economic crisis, most have a reasonably good budgetary situation. They have relatively few people on ART (Brazil is a notable exception) and the financial cost of their ART programs is not a large fiscal burden. These countries are also highly committed to providing access to treatment (Box 3).

BOX 3 Common characteristics of countries with AIDS treatment programs that are not seen to be at risk

- **Strong commitment to AIDS treatment:**
 - The principle of universal access to health services is recognized as a universal right and applies to HIV diagnosis, treatment and care (e.g. Brazil, Chile)
 - Treatment is a priority of the Ministry of Health
 - Antiretroviral drugs are included in national drug guidelines and drug access is supported by a solid procurement system.
- **The health system has capacity** (including health personnel) to provide treatment.
- **Sufficient national resources** allow countries to fund their treatment from domestic revenues or social insurance funds.

Caribbean countries are likely to be affected. One of four Caribbean countries surveyed reported an impact already; another expected an impact in the next twelve months because the global crisis is depressing household incomes and government budgets (Box 4). The other two Caribbean countries surveyed have secure external funding for their programs.

Asian and Pacific countries see no impact yet and most expect no impact on their treatment programs in the next 12 months. This region includes countries heavily dependent on external funding but with firm commitments of financial support from donors (especially the Global Fund)—at least in the short- to medium term. Other Asian countries (e.g Thailand) are export-dependent and finance treatment programs mainly through their own national budget. Both situations could affect future treatment sustainability and scale-up.

Over half the countries in **Eastern /Central Europe and the Commonwealth of Independent States** (55%) expect to be affected in the next twelve months (6 of 11). This group includes countries which have been extremely affected by the economic crisis, with large exchange rate devaluations substantially increasing the cost of antiretroviral drugs and other health supplies.

In **West Africa**, treatment programs that serve a substantial percentage of people on ART may be affected. Only 1 of 11 countries reported an impact so

BOX 4 How Do Countries Adjust? The Case of Bahamas

Economic crisis has resulted in:

- Drug shortages and slow-down in drug delivery
- Increased unemployment and loss of income. This is affecting the general health and welfare of people with HIV, and in particular nutrition which is an important prerequisite for taking antiretroviral drugs
- Increased demand on public social sectors: some children are being moved from private to public schools
- Reduction in the number of private physicians in clinical care. This has led some people living with HIV to choose to get ART without medical assessment and care as they are not willing to use public clinics because of fear of being stigmatized.

Faced with a shortage of funds the government is focusing on:

- Closer monitoring and accountability of drug procurements (cost, etc.)
- Better planning and forecasting of ART needs
- Substitution of generic drugs to reduce costs
- Rationalization of drug regimens
- Increased focus on adherence to keep people on first line drugs longer
- Mid-term evaluation of health sector with presentation to Cabinet and Prime Minister to assess possible re-programming.

far, but 4 expect an impact during the next twelve months which could affect 76% of the people on treatment in this region.

Eastern and Southern Africa is the region most likely to be affected. As most of these countries' AIDS treatment programs are largely funded by external assistance, few countries report any adverse impact to date (4 out of 16). However, this region includes countries that are highly vulnerable to the global economic crisis. With a few exceptions such as Botswana and South Africa, most countries have limited fiscal space that they could use to cushion the impact of a decline in external aid; large percentages of households are poor; and the large number of people on treatment means a high treatment program costs. For these reasons, 9 countries expected their treatment programs to be affected by the global crisis during the next twelve months. These 9 countries represent 69% of the people on treatment in the region as well as 73% of those on treatment worldwide.

BOX 5 Reported impact of global crisis on countries' AIDS programs reported

The global crisis is affecting high HIV prevalence countries through different channels, such as:

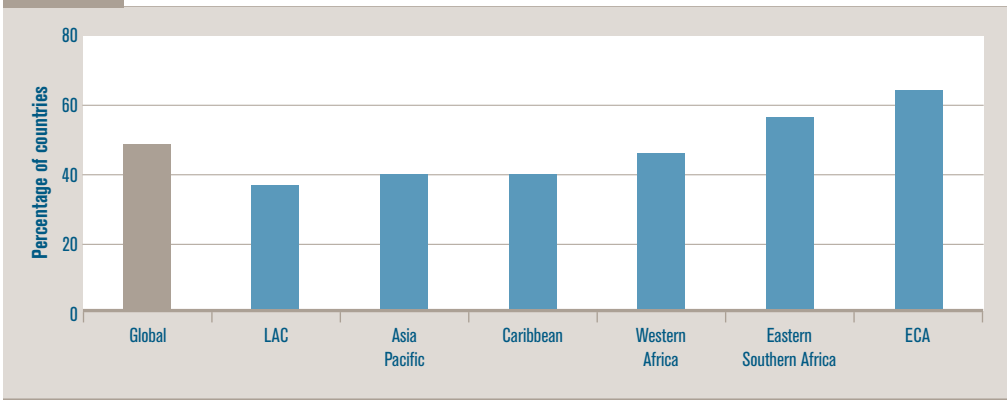
- **Budgetary cuts for HIV/AIDS.** One example is Tanzania, which announced a cut of 25% in its HIV/AIDS budget.
- **Reductions in health budgets.** This could affect ability to maintain salaries of health workers, and cause shortages of drugs and other essential health supplies. Examples include Kenya and Southern Sudan.
- **Cuts in external aid.** Papua New Guinea reported a cut of 75% due to a fall in external assistance. Some countries also reported being affected by the 10% cut in funding allocations in the Global Fund 8th round.
- **Contraction of economic activity affecting private sector.** South Africa indicated that large private firms (especially mining companies) are committed to continue funding AIDS treatment; however, they are likely to cut their HIV prevention programs.
- **Increased poverty.** Loss of income and increased poverty is likely to worsen nutrition. This is leading poor people to discontinue their medication due the lack of access to food.
- **Concerns are expressed** that job and income losses may result in desperate people exchanging sex for money and basic needs.

Source: World Bank/UNAIDS/WHO Survey of 69 countries

IMPACT ON PREVENTION PROGRAMS

Nearly half of the surveyed countries expect the global crisis to adversely affect prevention programs. As these countries include 75% of the people living with HIV, the potential adverse impact on prevention is worrying (Figure 7). Respondents expected most adverse effect on prevention efforts among marginalised most at-risk groups—injecting drug users (IDUs), sex workers, and men who have sex with men (MSMs) who tend to get lower priority than, say, pregnant women and children. This concern was most pronounced in the ECA countries (7 out of 11), but expressed in all regions.

In nearly all regions more countries expect a greater impact on prevention programs than on treatment. The issue of the proper balance between prevention and treatment is not new, but has added urgency when resources are scarce. Faced with such a situation, most governments tend to implement programs with clearly identified financing and measurable short-term benefits, while cutting those that do not, even though they may have very high priority.

FIGURE 7 Adverse Impact on Prevention (% of countries)

Source: World Bank/UNAIDS/WHO Survey.

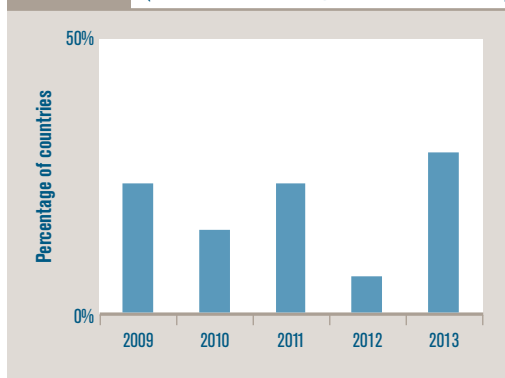
The economic crisis will force more careful use of resources. A few countries indicated that fear of reduced ART funding has heightened concerns regarding treatment sustainability, and given new urgency to discussions on how to ensure that existing resources are targeted well and used effectively and efficiently. Relentless and rigorous efforts to do this in all countries are needed, and could have lasting benefits.

VULNERABILITY FACTORS

The global economic crisis is exposing households in all developing countries to increased risk of poverty and hardship. This risk is compounded when governments faced with declining budgetary revenues and/or external aid have to cut their delivery of health services. How real is this risk? To answer this question, it is useful to classify countries according to the extent to which treatment programs are funded by external aid financing or domestic revenues, and whether their ART programs represent a large financial burden (summarized in Figure 4).

External aid dependency. At one other extreme are countries with large ART programs that rely mainly on external financing. Eighteen countries (out of 47 that provided financing information) said their external financing grants (usually from the Global Fund) end in 2009 or 2010. Longer term financing

FIGURE 8 External Financing for ART
(% of countries funding expiring in the next five years)



Source: World Bank data.

could provide better sustainability of programs. However, only 30% of countries had guaranteed financing that covers five years (Figure 8). In most, the guaranteed funding will ensure provision of ART to people already on treatment, but not necessarily to expand access, far less to reach universal access. Future funding increases are seen as uncertain. Ethiopia has decided to prepare alternative scenarios to identify policy options in the eventuality that their external assistance would remain constant or be cut.

Fiscal burden of ART programs. Countries that finance their antiretroviral programs nearly entirely from domestic budgetary revenues are among the least exposed to treatment disruption (Figure 4). The survey highlighted 10 middle-income countries which have some regional support for treatment programs and can finance their ART programs through the government budget or national health insurance.

Countries where AIDS treatment and health outcomes are most exposed to the global crisis are 15 mostly low-income countries with large ART programs serving a large percentage of people on ART in the developing world, most financed through a mixture of domestic and external financing. They include most countries in Eastern and Southern Africa.

The 25 countries with small ART programs are not all immune to the crisis. Despite having no more than 1,000 people on treatment, eight countries reported an impact already or expected this year, 11 more were uncertain. The challenge confronting these countries is that their small programs may not receive the same degree of attention as countries with much larger ART programs.

Capacity to respond. For countries faced with declining external aid, the sustainability of their ART programs depends on their capacity to adjust to falling revenues by increasing their budgetary expenditures and their institutional capacity to prioritize the allocation of limited resources. Do the affected

countries have the internal resources to do it? To answer this question, the survey examined fiscal space and institutional capacity in the 22 countries where treatment programs appear vulnerable to the crisis. As summarized in Table 1, most of the countries have low or medium institutional capacity, and none have both high capacity and considerable fiscal space.

The dispersion of countries in Table 1 highlights the diverse needs of countries. For instance, the four countries with “more” fiscal space and low institutional capacity may need primarily technical assistance. In sharp contrast, the main need of the country with low fiscal space and high institutional capacity is additional external financing.

HIV/AIDS TREATMENT PROGRAMS AND RISKS

ART, typically three drugs taken daily, suppresses levels of HIV (“viral load”) in the blood to undetectable levels, and stops the progressive damage to the immune system and development of severe morbidity. But if ART is interrupted, all three drugs are not taken, or adherence is poor, the virus will no longer be suppressed. Once the viral load becomes high, immune system damage and life-threatening illnesses are likely. Most people who stop and do not restart ART will die within one to two years. If drug resistance develops during ART interruption, then a switch to second line drugs could be necessary to prevent progression. In nearly all low- and middle-income countries, second line therapy is much less available and 5 to 10 times more expensive than first line therapy.

TABLE 1 Affected Countries, Fiscal Space and Institutional Capacity

Institutional Capacity	Fiscal Space			Total
	Low	Some	More	
Low	1	1	4	6
Medium	4	6	2	12
High	1	3	0	4
Total	7	10	6	12

Note: Classification based on the World Bank Country Policy and Institutional Assessment for fiscal space and institutional capacity. See www.worldbank.org

The striking success of ART in developed countries—in the USA, AIDS deaths declined 83% between 1995 and 2001—coupled with growing international realization of the catastrophic impact of AIDS, particularly in Africa, lent support to rapid expansion of HIV treatment programs in developing countries. New approaches to health care were developed to deliver and monitor this complex therapy by the simplest possible methods—the “public health approach”—and prices of ART drugs fell dramatically. Concerns that expansion of ART in developing countries would result in high levels of drug-resistant HIV have not materialized. Patients in Africa take their medications with the same—or greater—care as their American counterparts. The numbers of people requiring second line therapy have so far been small and drug resistant HIV in the population has remained at low rates.

Even short-term interruptions of drug supplies could threaten patients’ health, cutting the returns to the investments in treatment. The number of ART interruptions of more than two days, and duration of interruptions increase the risk of treatment failure. Up to 50% of patients whose treatment is interrupted for 15 days may subsequently need a different regimen. If treatment interruptions become frequent for many individuals currently on ART, the risk of transmission of drug-resistant HIV will increase.

Tuberculosis (TB) epidemics are being driven by HIV in heavily impacted countries, and most TB cases are also people in their prime earning years. People with immune systems weakened by HIV have an estimated 10% per year risk of developing TB compared to a 10% lifetime risk for people without HIV. ART protects immune systems and reduces the risk of developing TB. Last year, a Bank study projected that implementing the Global Plan to Stop TB (relative to a no-DOTS scenario) would save 14 million lives by 2015 and that the broader economic benefits would exceed costs 15-fold in the 22 high-burden TB-endemic countries. These programs are also vulnerable to the impacts of the economic crisis. Faltering support for TB programs will mean fewer cases are detected and successfully treated. An increase in poverty that facilitates the spread of TB and increase the number of cases would add stress to already overstretched health systems.

The international community is obligated to continue support to people it has placed on ART. First, “do no harm” is the ethical principle is fun-

damental to medicine and public health. The international community has made an unambiguous and admirable commitment towards universal access to treatment for people with HIV who need it. There also is an obligation to ensure that an exit from externally funded programs does not leave people and countries worse off than if there had been no outside intervention. If supplies of ART falter and people are turned away from clinics (as already seen in some countries) and treatment interrupted or stopped, some increase in drug resistance in TB and HIV is likely. The disorganized failure of public health treatment for AIDS and TB through lack of funding will burden countries with a cohort of sick and dying citizens, some of whom will not be treatable with first line therapies. The costs of such a failure would go beyond expensive second line regimens and lost life years, and extend to the legitimacy of development assistance for health.

IMPLICATIONS: INNOVATION AND ACTION

HIV poses three major health challenges in responding to the global economic crisis:

- ❑ **Protect long-term human capital investments.** An important lesson learned during previous crises is that cuts in core social services have long-term effects. Responding to immediate fiscal pressure by reducing spending on HIV treatment and prevention will reverse recent gains and require costly offsetting measures over the longer term.
- ❑ **Ensure health system capacity.** Declining economic growth combined with cuts in social public expenditures will leave many households exposed. Critical to protecting people's health will be the ability of governments to offset declines in domestic health spending with increased access to external financial support to ensure the delivery of core health services, including HIV and TB treatment and effective HIV prevention services.
- ❑ **Prevent backsliding on progress towards universal access.** According to UNAIDS, AIDS deaths have fallen significantly globally with the remarkable expansion in treatment access in recent years. But the huge backlog of people who urgently need treatment continues to grow. Many countries will require additional support to secure long-term financing

for HIV, and it seems likely that the degree of aid dependence for HIV programmes is set to increase in the short-run.

Meeting these challenges will require innovative thinking and action by governments and their development partners.

- ❑ **A more rigorous and determined push for efficiency and cost-effectiveness especially in HIV prevention is imperative.** Countries facing budget cuts might be offered rapid response technical support to identify potential efficiency gains and areas where budget cuts might have the least impact. Development partners can step up efforts to assist countries to better prioritize resource allocations across prevention and treatment programs, and to focus on evidence-informed, results-driven programs. This includes taking advantage of synergies and efficiencies that may be possible by better integrating health services.
- ❑ For countries with high reliance on external funding for AIDS, national authorities and partners could **identify impending cash flow interruptions and provide bridge financing that, at the least, prevent treatment interruptions.**
- ❑ For countries receiving emergency budget support, **an appropriate base level of funding for HIV could be identified to be included as part of the social protection package.**
- ❑ **A simple early warning system might be established to track and minimize treatment interruptions.** In addition, assisting countries to strengthen their ability to forecast future drug demand would also help prevent stock-outs of drugs and other essential health supplies.

In an environment of sustained uncertainty, policy makers face difficult challenges in setting priorities and maximizing the development impact of their spending. The task is made less difficult if national HIV/AIDS strategies (i) are informed by evidence and prioritized on the main drivers of the country's epidemic; (ii) support programs that have demonstrated impact; (iii) provide services at the lowest costs consistent with agreed standards; (iv) reduce waste through strong fiduciary and governance structures; and (v) strengthen health systems; (vi) are implemented through annual action plans that are consistent with the strategic goals and directions.

The global community should act within a coordinated framework of analysis and advice so that countries do not receive multiple or conflicting assessments and recommendations. The AIDS Strategy and Action Plan (ASAP) service of UNAIDS has begun developing a Economic Crisis Impact Assessment Tool (FinCIAT) that will assist countries to review their epidemics and current responses, and to look at key choices in revising their HIV/AIDS programs in light of the economic crisis.

Social Safety Nets, Labor Markets and Pensions

Using Social Safety Net Programs to Respond to the Current Crisis

The sequence of food, fuel and financial crises bring threats to human development from two angles. First, falling real wages and employment impede households' ability to provide adequate food and necessities to their members. Second, the squeeze on government budgets usually reduces services to the poor, during a time when people are switching from private to public education and health services. Absent assistance, households may be forced into the sale of the assets their livelihoods depend on, withdrawal of their children from school, inadequate use of health care, inadequate diets and resulting malnutrition. Many millions more will be poor, and progress toward the Millennium Development goals will slow down.

Safety nets serve not only as immediate relief, but in concert with protection of the budget for key services, help safeguard education, health and nutrition outcomes contributing to medium-term growth.

On average, safety net expenditures in developing countries fall in the range of 1 to 2% of GDP, though some countries spend much less or much more. Safety net systems are composed of several, sometimes many, programs. Expenditures on cornerstone programs that are to scale and evaluated as delivering significant positive impacts, such as Mexico's *Oportunidades* program or Brazil's *Bolsa Familia* program, are on the order of 0.4% of GDP. Ethiopia's largest safety net program, the *Productive Safety Net*, costs about 1.7% of GDP.

Current levels of spending on social safety nets are sometimes insufficient to meet needs, especially in poor or low spending countries or in times of crisis. In the Kyrgyz Republic, social assistance expenditures were less than 0.8% of GDP in 2007. The targeting of the main programs (unified monthly benefit and monthly social benefit) is good, but coverage is low—less than half of the poorest 10% of the population receive benefits. Moreover, benefits are low, having been raised from about \$2/month to \$3/month in response to the food price crisis.

Adequate financing of safety net spending requires the re-prioritization of public expenditure, especially due to the current strains on government budgets. In some countries, additional fiscal expenditures are also likely to be required to ensure adequate coverage and benefit levels of existing safety net programs in stable periods. Further time-bound increases will be needed in times of crisis. Aside from increases in domestic revenue mobilization and foreign assistance, reallocations of spending can be an important source of financing for an enhanced safety net package.

Significant efficiency gains within the existing safety net system can be realized. A number of countries have many small programs, each unable to fully reach economies of scale or efficiency, often with overlapping goals or target populations. Reform of these systems can yield better results within a similar budget envelope. Ethiopia, for example, merged several donor programs to form the *Productive Safety Net* initiative, Brazil merged three prior programs into the *Bolsa Familia*, Jamaica merged three prior programs into the *PATH* program, in each case with improvements in systems and outcomes.

There is a substantial menu of possible safety net interventions possible. These include: cash transfers of various kinds (unconditional or conditional transfers targeted on the basis of poverty, unemployment benefits, family allowances, social pensions); various in-kind transfers, especially maternal-child or school feeding; public workfare jobs; waivers of fees for essential health, education or utility services, etc. Various labor market policies such as unemployment benefits, temporary payroll tax holidays and credit to small enterprises can help as well. Nutrition programs for pregnant women and children under 2 years old can help households make the most of scarce food, and micro-

nutrient fortification or supplementation can help compensate for inadequate diversity in foods consumed.

The criteria for selecting safety net programs for scaling up in response to economic crisis are the same as for other types of crisis. Speed of response is a dominant criterion, adequacy of coverage and benefit are important, and good targeting and cost-effectiveness are desirable. Countries with adequate safety net systems can scale up quickly to respond to crises as in the case of the majority of countries in Eastern Europe and Central Asia.

In countries lacking adequate safety nets, it is important to start building basic systems for targeting, payments, and monitoring, using innovative arrangements as needed. Community structures, social funds, NGOs, private contractors or donor agencies may carry out some functions done in other settings by government ministries or municipalities, services may be simplified, and standards fit to local capacities. Though starting a new program can be slow (taking as much as 6 to 18 months before significant benefits flow and longer before the program is running optimally) it is still worth the time and resource investment. Experience suggests that crises of one sort or another occur frequently. Evidence from prior crises also shows that poverty and unemployment can take several years to fall to pre-crisis levels. Moreover, programs built for a crisis can become the basis for a more permanent safety net, needed (perhaps at a smaller scale) because even in prospering economies, there will be households facing household-specific crisis and chronic poverty.

While all crises require safety nets, the profile of affected households and therefore the type or mix of programs appropriate to use may vary according to the type of shock. The spike in international grain prices, for example, translated into broadly higher prices for staples in many countries, affecting a large number of poor people. Scaling up the benefit levels of safety nets already adequately serving the chronic poor was a largely sufficient response, as when Brazil increased the transfer values of its *Bolsa Familia* program and Mexico for its *Oportunidades* program in the spring of 2008. Where safety nets were insufficient at the beginning of the crisis, simple tools for targeting the chronic poor in order to extend coverage were applied—for example, targeting school feeding programs to poor districts, as done in Liberia, Sierra Leone, and the

Central African Republic, or scaling up the coverage and benefit of the *Unified Monthly Benefit* program in the Kyrgyz Republic.

The current global economic crisis is also affecting groups who are typically not part of traditional safety net systems. For economic crises, broad poverty targeting is certainly necessary because poor people are often affected by the (often substantial) part of labor adjustments that occur through falling real wages, by the fiscal squeeze on public services they need, and because they start with the smallest margin of survival. But the economic crisis will also, in many countries, bring job losses and hardship to the middle class—a problem that can require additional programs and be harder to solve. For instance, in Cambodia, 10% of (mainly female) garment workers have lost their jobs over the past few months due to a slowdown in export demand. These formal sector wage earners, typically based in urban areas, are not among the poorest in society, and they are unlikely to take part in public works jobs which require hard physical labor typically in rural areas. Unemployment insurance can help such groups where such programs exist. Hence several countries (e.g. Argentina, Chile) are changing regulations to allow coverage of more workers.

In some countries, labor intensive public works programs can give an option to some workers. In Burundi, for example, the successful *Public Works and Employment Creation Project* is being used to absorb excess labor from the cash crop sectors which have been affected by the downturn. In past crises, Argentina, Bulgaria, and Korea's public works programs provided some jobs in the service sectors, but in general, it is much more difficult to organize and supervise such work.

Broadly, three key steps are required to strengthen safety nets that respond to the current and future crises:

- (i) **Augmenting fiscal space from donor resources and seeking efficiency improvements.** Many low- and middle-income countries are experiencing fiscal stress due to the crisis and protecting, let alone augmenting, safety net expenditures is proving to be a challenge. External resources, such as from the proposed Vulnerability Framework, may therefore be crucial. At the same time countries will need to create fiscal space for

safety nets by pruning lower priority budgeted items and seeking efficiency gains within safety net programs.

- (ii) **Promoting inter-governmental coordination for safety nets.** In many countries resources are often not put to best use due to the silos under which programs operate in various ministries. A strategic approach to the crisis would require the multiple agencies of government to work under the umbrella of a national safety net tsar.
- (iii) **Capacity building and knowledge sharing.** Building effective targeting and payment mechanisms, accountability systems and monitoring and evaluation for safety net programs requires a medium-term safety net strategy. Moreover, lessons from similar countries need to be shared so that resources are not wasted.

Labor Market Programs that Make a Difference in a Time of Crisis

SUMMARY

We are witnessing an economic crisis of colossal proportions that threatens to escalate to a full-blown economic and social crisis. Companies around the world are cutting production, closing factories and dismissing thousands of workers. Jobs are being lost on a large-scale around the globe—from carmakers in developed countries to shoe, clothing, and toy factories in developing countries. Current forecasts predict an increase in unemployment from 2007 to 2010 by 10 million workers in OECD countries alone.

The implications for the world's poor and most vulnerable populations are pervasive and could have dramatic and lasting adverse consequences. The global economy is expected to contract, following 3.1% growth in 2008, by 0.6% in 2009. This will be driven by negative growth in rich countries and by very poor performance in developing countries. The World Bank has recently estimated that growth in the developing world will fall 3.7 percentage points in 2009, from 5.8% in 2008 to 2.1%, which will push more people into hardship. Evidence from past crises has shown that the poorest, especially

unskilled, young, old, and female workers will be particularly vulnerable to the economic downturn. Failing to support them could severely endanger the long-term growth and poverty reduction prospects of developing countries.

The response to shocks of this magnitude must be comprehensive and should cut across many sectors of the economy. In particular, it should include the stabilization of the financial sector, the management of the fiscal challenges and the protection of the most vulnerable. The Bank has developed a cross sectoral framework (MILES) to help countries design strategies that protect workers and create better employment opportunities.¹⁶ Strategies designed using the MILES framework will help reduce poverty, stimulate economic growth and contribute to sustainable development.

Several networks within the Bank have already produced comprehensive guides on how countries should respond to the current crisis without affecting their long-term strategies. The objective of this note is to complement this work by focusing on the available labor market instruments that countries should (or should not) resort to when responding to these shocks.

The key policy recommendations of this note are as follows:

- ❑ **The labor market response should complement financial stabilization and macroeconomic measures.** While the Bank has emphasized the usefulness of an overall policy shift from protecting jobs to supporting workers, in times of crisis, policy makers might favor options that are costly but have strong political support. Each country will have to find the right balance when facing such tradeoffs, but it is important that labor market policies also focus on the groups that are the most vulnerable to the economic crisis—young people, the low-skilled, women, older workers, and immigrants.
- ❑ **Whether policies and programs are designed to protect jobs or to support workers, their suitability needs to be reexamined with a view of how they fit crisis situations.** What works in normal times might not

¹⁶ MILES stands for the five areas emphasized by the framework: Macroeconomic conditions, investment climate and infrastructure, labor market regulation and institutions, education and skills development, and social protection.

be the best option in the current climate. In addition to using best practice criteria, other aspects should be considered, above all (i) the speed and ease of program implementation, taking into account existing infrastructure and institutional capacity; and (ii) the ability to support groups most affected by the crisis.

- ❑ **To provide income support for the most vulnerable groups, middle-income countries should consider expanding and enhancing income support programs like unemployment insurance.** Low-income countries, on the other hand, should use public works programs, especially in rural and isolated areas.
- ❑ **Policymakers need to move away from ad hoc implementation of individual programs towards a comprehensive package** of training, income support, internship and re-employment services to deal with the multiple challenges workers will be facing. These programs, while costly, are more likely to be successful for youth, dislocated workers, and women.

IMPACT ON LABOR MARKET OUTCOMES

The global economic crisis threatens to imperil workers all over the world.

In the next several years, economic growth around the world is expected to fall sharply, which is bound to severely affect labor markets in developing countries. Millions of formal sector jobs will be destroyed, leaving massive numbers of workers unemployed. The contraction in labor demand will also reduce labor earnings across the wage distribution. Many households, especially the poorest and the most vulnerable, will have to increase their labor supply with young workers, low-skilled workers, women, older workers and immigrants being particularly vulnerable to an economic downturn. Not only will they be more likely to bear the brunt of rising unemployment, but they may also face difficulties finding new jobs, as labor markets become more stagnant.

How Will The Labor Market React?

The abrupt deterioration of the labor market conditions in OECD countries will bring unemployment in these countries to record levels. Unemployment rate in the US has jumped to a 15-year high at the end of 2008, reaching 6.7% and leaving 2.8 million workers unemployed. By November

2008, the unemployment rate among youth in the U.S. has reached 13.8%. Unemployment in the OECD is also projected to increase to 6.3% by the end of 2008 (relatively to 5.5% a year earlier). Current projections show further increase in the unemployment over the next 18 months, peaking at 7.3% in the second quarter of 2010. This will leave 34 million of individuals unemployed in 2008 and 42.1 million by 2010. Undoubtedly, unemployment in developing countries will also increase over the next years, especially in countries heavily dependent on international trade. The International Labour Office estimates that 5 million additional unemployed worldwide will be added to the ranks of unemployment in 2008 and an additional 15 million in 2009.

The economic crisis will reduce labor demand in developing countries through two main channels—restricted access to credit and reduced trading opportunities—leading to a fall in real wages and employment.

The economic crisis will tighten credit markets, restricting the direct access of national banks in developing countries to international credit. This has an immediate impact on firms' access to credit in developing countries, especially among larger and formal firms that tend to rely on formal financing facilities. Firms with greater capital and labor complementarities will also be hit harder. Moreover, the crisis will also reduce demand for exports of developing countries, and restrict their access to foreign direct investment (FDI). This shortfall of credit, exports, and FDI will affect job creation, both through reduced firm creation but also through reduced investment by existing firms. The expected fall in labor demand will lead to a fall in real wages and employment, especially among the larger and formal sector firms in developing countries.

Household labor supply is also bound to be severely affected. On the one hand, labor supply will be directly affected by a reduction in real wages leading to a disincentive to participate in the labor market (a “substitution effect”). On the other hand, the fall in wages, together with the potential reduction in migrant remittances (either from abroad or from urban areas) could generate a negative “income effect”, which could lead to an “added-worker” effect. Even though the overall effect on labor supply is ambiguous, labor supply may fall, especially for richer households that are less prone to poverty and less dependent on migrant remittances. Evidence presented in

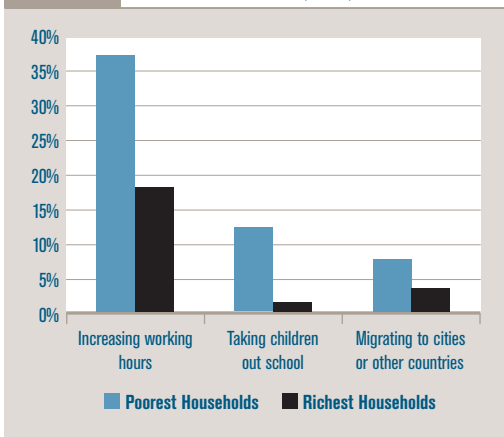
the Appendix for East Asia shows that this “added worker” effect increased aggregate employment in Indonesia and the Philippines.

The predicted reduction in remittances will also contribute to the “added-worker” effect. Remittances to developing countries shows a slowdown from 6.7% in 2008 to –0.9% in 2009. As evidence shows that remittances reduce labor supply of receiving households, particularly of women and children, this reduction is likely to reinforce the “added worker” effect.

Poor households may be forced to increase working hours, put children to work, or migrate in order to smooth consumption. When faced with a negative shock, households try to smooth consumption, and the mechanisms used for this depend on the household wealth. Richer households are more likely to reduce their labor supply (particularly via reduced labor force participation), relying on their wealth and savings. The reactions of poorer households are much more dramatic: they are much more likely to adjust consumption patterns, increase household’s labor market participation, and migrate. The evidence from the East Asian crisis is telling: the poorest in the Philippines had to resort more frequently than the rich to changing their eating patterns, taking children out of school, working longer hours, and migrating to urban areas or other countries (see Figure 9). Similarly, in response to the increase of poverty, Indonesian households reduced their investments in education, especially for the poor (see Box 6). Moreover, the Bank also shows that the ability of poor people to maintain consumption in the face of crisis-induced income shocks is more limited than the ability of the non-poor.

The financial sector, construction, and transportation activities, as well as urban areas in general, are expected to be the hardest hit. Because the current crisis is global in nature, exporting and importing firms will be directly affected, and their employment jeopardized.

FIGURE 9 Filipino Household Responses during East Asian Crisis (1998)



Source: Esguerra et al (2001).

BOX 6 East Asian crisis of 1998: Who was affected and how?

After almost three decades of sustained economic growth, Indonesia was severely hit by the East Asian crisis: in comparison to 1997, output in 1998 contracted by 13.7%, commodity prices sharply increased, and consumption decreased.

The brunt of adjustment was taken by wages—between 1997 and 1998, the median wages declined by 20–30%, with larger decline for men and urban workers. While men’s employment stayed unchanged, women’s employment rose, primarily because more women worked as unpaid family workers. Fewer men, but not women, held a secondary job in addition to their primary job, and the average working hours increased. Younger workers gained easier access to jobs in comparison to older workers, as did men in rural areas in comparison to urban areas. Younger, better-educated, and urban residents were also more likely to have moved between 1997 and 1998.

As a result of reduced consumption, poverty rates rose, with the larger households and those headed by younger heads particularly likely to move into poverty. Households spent relatively more on food and less on education and health care. The share of the household budget spent on education decreased from 3.43% in 1997 to 2.93% in 1998, with relatively poor households reducing their expenditures on education the most. In 1998, fewer children attended school, and both decreases in enrollment and increases in drop-outs have been largest for children from the poorest households (non-attendance among poor children increased from 5% to 10%).

About 2% of the workforce participated in emergency public works, with more than proportional representation of men and rural residents. In rural areas, better off households were significantly less likely to receive assistance from friends and family and only marginally less likely from government and NGOs. In contrast, in urban areas, assistance from friends and family to households was granted regardless of how wealthy they were, but wealthy families were less likely to receive assistance from government or NGOs.

Moreover, formal sector firms in financially dependent activities are also likely to contract, due to reduced access to and more costly credit. Other sectors bound to be more severely affected are construction (very affected by confidence levels and credit), tourism and transportation (with tighter links to the formal manufacturing sector). Therefore, urban areas, disproportionately populated with larger, formal and more open firms, will naturally be more affected.

Evidence from past crises shows that while changes in aggregate employment could be small, wages are likely to bear the brunt of the adjustment together with rising unemployment and underemployment. Evidence

from past crises shows that aggregate employment might not be too severely affected, especially in comparison with the falls in GDP. For example, aggregate employment in Indonesia continued to increase through the crisis while GDP was falling by almost 15% in 1998. Similar examples can be given for other countries during crisis, like Mexico and Turkey. Countries with rapid inflation episodes following the crisis (as those more dependent on commodity prices), and those with stricter employment protection regulations, will be more likely to adjust by reducing real wages, rather than employment or hours of work. Moreover, unemployment in countries with more formalized labor markets is likely to increase substantially: during the East Asian crisis, the unemployment rate increased from 2.6 to 6.8% in Korea and from 2.2 to 5.2% in Thailand (see appendix); similarly, during Argentina's crisis in the late 1990s, it increased from 11.7% to 15.9%. Reductions in working hours for both men and women helped keep unemployment increases small in some countries, like Indonesia.

Real wages will plunge in the formal and in the informal sector, affecting harshly those who are able to remain on their jobs. Real wages will fall in the formal sector, due to contracting labor demand. Displaced workers from the formal sector become unemployed or search for a job in the informal sector. This transition will increase labor supply, creating a downward pressure in wages in this sector. As the crisis unfolds, the aggregate reduction in labor earnings is likely to feed into a contracting demand in the informal sector (reducing labor demand and counteracting the effect on earnings in the middle run). In Indonesia, real wages per hour fell for men and women, in rural and urban areas between 1997 and 1998. Among the wage earners, evidence shows that wage declines were higher in urban areas and largest for the youngest.

Employment in agriculture and in the informal non-tradable sector is expected to increase during the crisis. Workers displaced from the higher paid formal sector either become discouraged (leaving the labor market), unemployed or move into the informal sector. Employment (and labor force participation) in agricultural activities is likely to rise due to the low costs of entry. Changes in employment composition in Argentina and Indonesia show that this is the case. Women and the youngest in the household, due to their prior smaller labor market participation, could be the most likely

candidates to become self-employed, unpaid family workers or workers with temporary contracts.

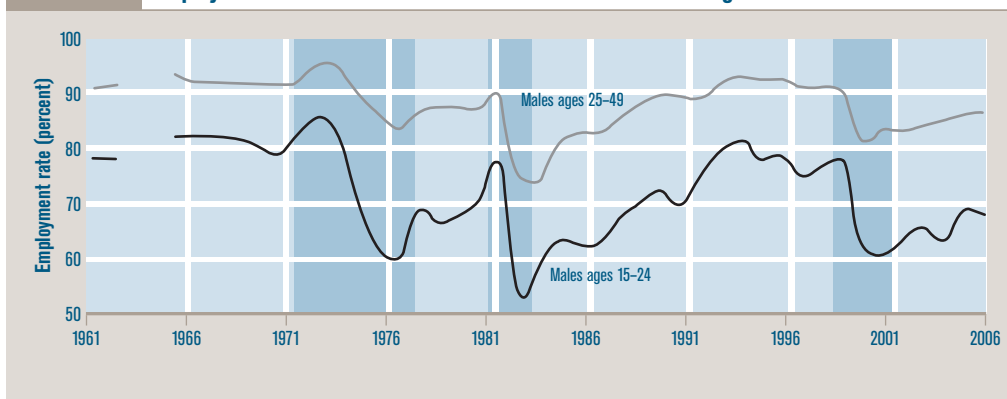
Which Groups are Worst Affected by the Economic Crisis?

Historical experience suggests that young, old, unskilled and female workers as well as migrants are particularly vulnerable to an economic downturn and are more likely to bear the brunt of rising unemployment.

Young people will be disproportionately affected by reduced job creation and increased dismissals. Reduced labor demand will imply fewer job openings coming either from new or expanding firms. As new entrants in the labor market are less skilled due to their shorter labor market experience, they are likely to be more severely hit by a contraction in labor demand (especially in the formal sector)—see Figure 10. Moreover, job closings are also likely to disproportionately affect the young workers, especially if the shock is expected to be short-lived, because young workers tend to work more frequently under temporary contracts.

When displaced, older workers face greater obstacles in re-entering the labor market. Older workers who are displaced due to firm closings or reduced investment are also likely to be disproportionately affected by the crisis. Evidence from the early transition to a market economy in Slovenia showed that older workers did not face a greater risk of displacement. However, they

FIGURE 10 Employment Rate in Chile Fell Twice as Fast for Youth during Recessions



Source: Fares and Montenegro (2006).

Note: Shaded portions represent periods of economic slowdown. Employment series are adjusted for school enrollment.

were much less likely to get a job after losing one and they also suffered much larger post-displacement wage losses once re-employed (the wage loss of workers with 25 to 30 years of experience was 36%, compared to no wage loss of workers with below 10 years of experience). Similar results are found for other countries.

The crisis will also affect unskilled workers and women more severely.

First, employers are more prone to dismiss unskilled workers, as they tend to have more flexible work arrangements and are not covered by labor market regulations. Second, unskilled labor is relatively abundant in developing countries, so employers are also more likely to displace this group first, especially if the shock is expected to be short-lived. Women, who tend to be disproportionately unskilled and have more flexible work arrangements, will also have more difficulties becoming re-employed, especially in stagnant labor markets and in economies with stricter labor regulations.

Migrants—both internal and international—are likely to be disproportionately affected.

Migrants are often among the first workers to be laid off because of their concentration in the most vulnerable sectors, such as construction or tourism, and because they frequently hold temporary jobs. When hit by a negative shock, internal migrants may have little choice but to return their home areas and engage in the traditional, low earning agricultural sector. As for international migrants, the global nature of the crisis makes it difficult to predict the direction and intensity of migration flows. Because of the global nature of the crisis, their prospects in the country of origin are bleak and thus returning home may not be a viable solution. Yet evidence from previous crisis—the East Asian crisis in 1997–98 and the Mexican Peso Crisis in the 1990s—shows that both return migration and emigration increased significantly.

HOW SHOULD LABOR MARKET POLICY RESPOND?

The labor market response should focus on the groups that are likely to be hit the most, and support them by programs that fall under two categories: *active labor market programs and income support programs.*

Policymakers everywhere are searching for the right policy response to the

crisis. Many countries have introduced aggressive fiscal measures to partly offset the financial shock and limit job destruction. While these policies fall outside the realm of the labor market, they will have immediate implications on jobs and workers. Beyond these measures, this section focuses on labor market policies that could complement financial stabilization and macroeconomic initiatives.

The spectrum of policies in the labor market can vary from job protection measures designed to limit job losses, to worker's protection programs designed to support the unemployed. The Bank has emphasized the benefits of an overall shift away from job protection (by increasing the flexibility in the labor market, for example) towards more protection for workers (by providing direct income support to the unemployed and better access to training). However, in times of crisis, countries need to act immediately and pragmatic policy advice needs to include innovative options that take into account the feasibility and political support of new measures. This section considers labor market policies and programs that seek primarily to reduce the risk of unemployment and wage losses as well as provide the income support to help mitigate the shock.

Previous experience has shown that bailout measures designed to keep jobs, while needed and politically popular, are costly in the short and the long run. Policy makers facing these important trade-offs should strike the right balance based on good practices and relevant empirical evidence.

Whether policies and programs are designed to protect jobs or to support workers, their suitability needs to be "reexamined" with a view of how they fit a crisis. In particular, the evidence on the effects of different interventions obtained from their functioning in normal times needs to be filtered through the reality that in the current crisis, these programs will be applied under slack labor market conditions, and hence previous evaluations may be of limited applicability. Therefore, in addition to using best practice criteria, three other aspects should be considered: (i) the speed and ease of program implementation, taking into account existing infrastructure and institutional capacity; (ii) the ability to support groups most affected by the crisis; and (iii) the likelihood of obtaining continuing financial support.

Active Labor Market Programs

Preserving jobs

Ad hoc policies that support troubled firms are difficult to resist during a downturn, but there are more effective ways to help workers. Rising unemployment and mounting political pressures will likely lead to some firm bailouts and restructuring programs designed to preserve jobs. With the exception of the financial industry, however, policies should aim to protect laid-off workers rather than failing firms. The promotion of voluntary work sharing, and targeted wage subsidies, for example, can help mitigate the adverse employment effects of the crisis.

Direct support to firms is less attractive during a protracted downturn.

The most compelling argument for directly supporting firms is the importance of keeping workers in their jobs during a temporary shock. However, there is no indication that the current downturn will be short-lived. Furthermore, once the precedent of bailouts is established, it may be politically difficult to decide when to limit or withdraw support in the face of continued financial difficulties. It may also be politically necessary for governments to insist on managerial control in exchange for financial support, which can lead to additional difficulties and inefficiencies.

Bailing out troubled firms can also have a negative impact on labor productivity, and have a smaller effect on net jobs than is often assumed.

A Bank study of labor productivity changes in seven countries found that firm exit in the manufacturing sector was a significant contributor to increased labor productivity in all seven countries. For example, firm exit accounted for roughly 70% of the increase in productivity in Chile between 1983 and 1999. Firm exit, besides raising labor productivity, may have a smaller effect on net jobs than is commonly assumed. During the transition to capitalism in Eastern Europe, there was no correlation between firm exit and job destruction, as countries with greater job destruction instead experienced more downsizing within firms.

Japan's response to the 1990 recession illustrates the perils of keeping large numbers of insolvent firms afloat. The bursting of stock and real estate bubbles in the early 1990's was the trigger for a decade of stagnation. Banks responded

to the downturn by consistently restructuring loans to insolvent firms. At one point, nearly 30% of publicly traded construction, real estate, retail, manufacturing, and service sector firms were insolvent, and survived mainly as a result of lax lending practices. The survival of large numbers of impaired firms discouraged the entry and investment of healthy firms, and led to slower job creation in industries with large concentrations of insolvent firms.

In time of crisis, work sharing is one alternative to layoffs. Work sharing is aimed at enabling employers to retain skilled workers and workers to avoid layoffs associated with temporary economic downturns. Under such arrangements, workers agree to reduce their working time and to accept a cut or proportional reduction in earnings. Work sharing, which is often intended as a temporary measure, is typically undertaken through voluntary agreements by workers and firms. Mandatory job sharing, in contrast, has generally not proven to be an effective job-creation strategy. Several studies on mandatory reductions have found either small or negative effects on employment.

Extending partial unemployment insurance to part-time workers would encourage work sharing. Unemployment insurance is often granted to workers that are laid off, but not to workers that voluntarily agree to a cut in their hours worked. One alternative is to provide a mechanism whereby workers can receive Unemployment Insurance (UI) benefits in proportion to their reduction in hours, which would help cushion the financial blow from workers that voluntary cut-back on their hours.

Wage subsidies or payroll tax holidays could boost employment for young and old workers. Age is an attractive basis for targeting vulnerable workers, because firms do not account for the social costs of firing younger and older workers. Subsidies for youth employment make sense for two reasons. First, several studies have found that youth unemployment leads to a persistent disadvantage in the labor market that can take years to overcome. Youth unemployment can be even more likely to occur if minimum wages are set at a high level. Second, is that unemployed youth may be more prone to crime or causing social unrest. Older workers tend to face greater difficulty finding new jobs than younger workers, because they have built up more specific skills. These wage subsidies for older workers can provide firms with an additional incentive to keep them on the payroll.

Programs for young people

Because young people suffer disproportionately from reduced labor demand, it is important to help with targeted interventions. Such programs limit the scarring effect among youth and provide them with the skills they need as they move through different spells of employment during the short term turbulence and what the market needs as it recovers post the crisis. Recent lessons from evaluations of youth interventions in developing countries show promising trends and should be taken into account when designing new programs.

Comprehensive programs that provide training as part of a package are likely to have better success. In Argentina, Chile, Peru, and Uruguay the *Joven* programs have been widely recognized as successful in reaching disadvantaged youth. Critical to their success is the nature of the training—from technical to life skills and from lectures to internships—and the sound support services and course certifications that foster youth’s continuing participation. Private and public institutions contracted through public bidding mechanisms provide the training and organize the internships. The programs target poor people, and more than 60% of participants come from low income families. The highest education level completed by beneficiaries was secondary, with significant participation by school dropouts (50% in Chile *Joven*). The programs increased the probability of beneficiaries finding employment upon graduation, especially for women. A recent meta-analysis of six *Entra 21* projects shows that employment rates for participants rose from 15% at the start to 54% 6 to 12 months later. Earnings for participants, relative to their pre-program earnings, were also shown to have increased.

Although *Joven* programs are costly, they are good candidates to be applied to other countries and regions. Estimates from Chile and Argentina for the cost per trainee range between US\$ 700 and US\$ 2,000. The gains in terms of employment and earnings are also significant and are likely to offset the initial costs. It is also important to note that the party incurring the direct costs (public funds) is different from the party benefiting from the program—the participants. Most of the programs have been implemented in countries in Latin America, and very few have been tested in other regions. Transferring the *Joven* model to other developing countries requires strong institutions to manage a decentralized program and to coordinate the goals

and operations of training institutions and participating companies. They are proven to work for the most disadvantaged, but they could face important challenges when taken to a large scale, particularly in times of crises when large cohorts of heterogeneous new entrants have difficulty finding work.

Training low-skilled unemployed and dislocated workers

For workers who lose their jobs and are forced into either unemployment or underemployment, training helps them acquire the skills they will need to find new and/or better employment opportunities. For dislocated workers involved in massive layoffs, retraining provides them with new skills to replace their current skills, which may only apply to industries and firms with systematic declining demand. Because the record from evaluations of supply driven training programs is not favorable, it is important to tailor training programs to best fit the local needs and combine training with some sort of income transfers to the poorest.

Training is the dominant active labor market measure implemented worldwide to develop skills among workers of all ages. While the record on how well these programs function is mixed, recent evidence indicate that program designs that combine different training approaches have a higher probability of yielding positive labor market impacts on employments and/or earnings outcomes of trainees. In particular, compared to in-classroom training alone, the interaction of in-classroom and workplace training increases the likelihood of positive labor market impacts by 30 percentage points, and when combined with other services, the probability of a positive impact increases by 53 percentage points.

In time of crisis, training needs to be combined with (or even become a condition for) income support for workers. In Mexico, the *Job Training Program for Unemployed Workers* (PROBECAT) combined short-term training for unemployed and displaced workers with income support (at the minimum wage) and placement services from the local employment offices. On-the-job training was found to be more effective than classroom training, and private training centers seem to outperform government-run centers.

Dislocated workers are usually geographically concentrated and have specific skills and experiences to industries and firms with structural

declining demand. These particular characteristics make it a challenge to retraining for these workers to allow their reintegration into the labor force. There is little evaluation evidence to draw on, in order to learn about potential successes. It is likely, however, that the contributing factors to successful general training programs (demand-driven, combined types of training and services) will also enhance programs targeting dislocated workers. In China, where large scale displacement resulted from a massive restructuring in the state owned sector, longer duration programs and workers' contribution were important design features that were associated with higher employment rates for laid-off workers.

Re-employment services

Given the large scale of the crisis and its implication on the labor market, policymakers need to move away from ad hoc implementation of individual programs towards a comprehensive package of services to deal with the multiple challenges workers will be facing. Many workers will lose their jobs during the crisis. Some of them will be part of massive layoffs from firms and industries that will not survive the slowdown. For those workers and firms, special retrenchment programs are needed. Unemployed workers will need access to better employment services to help them find work, and to training programs to prepare to find work in different sectors and/or to support them in starting their own work.

***Retrenchment programs.* Because struggling sectors are unlikely to emerge intact from the current crisis, public support for either downsizing or comprehensive restructuring will be needed.** Retrenchment programs—a package of services that include a combination of severance pay, unemployment benefit, training, and placement programs—have been used in implementing public sector reform during periods of radical transformation, including the restructuring of the labor market in the transitions economies in Europe.

Voluntary retrenchment programs need to be tailor-made to avoid adverse selection problems, and are less likely to work during a crisis because of more limited alternative opportunities for workers. Because productive workers with good outside options are most likely use voluntary programs, selection problems are likely to limit the effectiveness of voluntary retrenchment

programs. In times of low job creation, this selection problem is even more severe. **Mandatory retrenchment programs** can be an alternative for industries that will not survive the crisis to provide income support for laid-off workers, upgrade their skills, and search for alternative employment opportunities as the economy recovers. Absent a blanket bailout for such industries, mandatory retrenchment programs are costly short term measures for public finance that are only justified by the long term improved allocation of labor and higher productivity.

Job search programs to support job seekers by increasing access to information and labor market intermediation are not likely to have large impact in times of weak labor demand. While the general assessment of these programs is favorable because of their relatively low costs and comparable effect to other active labor market programs, their effectiveness depends largely on the status of the labor market. In periods of rising unemployment and lack of job creation, these programs have shown limited impact unless they are combined with other types of interventions. The performance of these programs can be also constrained in countries where informality is dominant and hiring relies mostly on informal channels, and in countries with weak public institutions. However, there is new evidence that the private sector can play an important role in providing labor market intermediation and temporary help.

Support for micro firms and promotion of self employment. During the current crisis, access to finance has become very difficult, while self employment could provide an alternative to formal and/or paid employment. As a result, programs that typically provide financial and advisory support for firm start up and/or support for the operational costs of micro firms might be needed. The advantage of these types of programs is that they help a subgroup of the population, which is more prone to self employment and is facing additional constraints in this time of crisis. For example, during the recovery from the Argentinean crisis, these programs helped women with previous experience in business; however, they are unlikely to be a viable solution for mass unemployment and displacements. The main benefits of this type of program is that they will mitigate distortions arising from credit rationing and, since they are well targeted, will not be very expensive.

Income Support Programs

Scaling up the support via unemployment benefits should be one of the key labor market policy responses. Other options include the provision of conditional cash transfers, and strengthening public works—the program particularly appropriate for low-income countries and crisis times. While countries may be tempted to use early retirement programs, they have proven to be fiscally expensive and ineffective in promoting the employment of young workers.

Expanding unemployment benefits

There are several options to scale up unemployment benefits: temporary increases in the generosity of benefits, expanding coverage, introducing new forms of benefits, reducing or temporarily suspending UI contributions, and enhancing the use of active labor market programs after the expiration of benefits.

- ❑ **Potential benefit duration can be extended**, for example from 6 to 9 months (as is the case of the US), or selectively for some groups of workers (above a certain age, for example).
- ❑ **Coverage can be extended to groups previously not covered** (for example, to workers with short prior employment, to those completing prolonged training courses or exiting from public works, and to workers in small enterprises). For example, Korea expanded the coverage during the 1998–99 economic crisis to cover workers in smaller firms, which provided help to the swollen ranks of the unemployed.
- ❑ **Short-time compensation could be introduced.** To stimulate employers to keep their workers in times of weak demand, this option permits employers to reduce the number of work hours of workers, with the lost wages of affected workers being partially compensated using unemployment insurance benefits. These programs—in demand also in non-crisis times—are well-established and widespread in Western Europe, the United States, and Canada, but they are non-existent in transition and developing countries. The structure of benefits, eligibility conditions, and financing vary greatly across countries. Usually, workers that reduce their work hours receive pro-rated unemployment insurance benefits for the hours lost due to work-sharing, benefit duration is limited to 20–30 weeks, and there is a floor (and sometimes, a ceiling) for the percent of the workforce that reduces work hours.

- **Worker, and perhaps also employer, unemployment insurance contributions could be temporarily suspended or reduced**, to increase purchasing power of workers and reducing employment costs (as Netherlands did in its recent measures to stimulate the economy).

In adjusting their unemployment insurance programs, the countries can take advantage of the World Bank Unemployment Insurance Simulation Model (UISIM) model. This is a new tool developed to assist client countries to make projections of unemployment insurance benefit costs, contributions, and trust fund balances. The model assesses the financial status of existing unemployment insurance schemes under different economic scenarios and can also generate financial projections of newly developed UI programs.¹⁷

Some countries currently without unemployment benefit programs may also want to introduce a simple version of such a program. Although developing countries are, in general, less suitable candidates for such a program than developed countries, for a subset of these countries a case could be made for the introduction of unemployment insurance.¹⁸ Of course, faced by large informal sector, weak administrative capacity, and environment prone to corruption, developing countries should tailor the OECD-style UI program to suit their circumstances. To ensure affordability and to enable a quick start, such adaptations include (i) simplifying monitoring of job-search behavior

¹⁷ The current version of the model has been piloted in three countries (Bosnia and Herzegovina, Turkey and China). The model is user-friendly, it can be adjusted to fit the UI system of almost any country, and it is powerful enough to provide accurate estimates for numerous variables of interest.

¹⁸ Prompted by increased exposure to foreign markets and fearing future international crises, more developing countries (including lower middle-income countries such as the Philippines and Sri Lanka) have been contemplating introducing UI. Such considerations are bolstered by the prospect of efficiency and distributive advantages of reforming social protection programs in developing countries. Namely, in many developing countries the balance between job and worker protection is tilted in the favor of the former: virtually all have—typically very restrictive—severance pay programs, and very few have UI programs. It is often argued that removing excessive job protection would not only boost the creation of more and better jobs, but also improve job prospects for vulnerable groups. And it goes without saying that reducing job protection is an extremely sensitive task that can often only be implemented if accompanied by introducing or strengthening income protection programs for workers—UI being one of them.

and labor market status, and even eliminating personal monitoring of continuing eligibility requirements in the early phases of the program; (ii) keeping modest benefits both in terms of the replacement rate and potential benefit duration; and, most important for the quick deployment, (iii) piggybacking on existing networks and administrative capacity to deliver and administer benefit claims. Indeed, by relying on social security agencies to administer the contributions and benefits, the program can be introduced fast enough to help countries in alleviating the consequences of the current crisis.

Conditional Cash Transfers

CCTs can help families reduce child labor risk. For many poor families, child labor represents a significant share of household income. For example, in Brazilian households in which children work, child labor represents 17% of urban household income and 22% of rural household income. As a result, when poor families are faced sudden loss of income, child labor goes up, as recently documented in Burkina Faso and Guatemala. While the ILO has estimated a significant drop in the incidence of child labor worldwide during the last decade, the current crisis threatens to offset all these gains.

CCTs are social assistance programs that provide regular benefits, typically in the form of cash, to households that satisfy certain conditions, such as health clinics visits and school attendance. While these programs are not primarily designed to deal with child labor, by increasing school attendance and by compensating families for the opportunity costs of not sending their children to work, these programs can help in limiting the household's use of child labor in response to the decline in household income. Furthermore, the design of these programs can be adjusted to increase the impact on child labor incidence. For example, in rural Brazil, CCT programs such as PETI (*Program to Eradicate Child Labor*) were actually shown to be successful in reducing child labor incidence by providing support to income-constrained families conditional on their children attending school and after-school programs.

Strengthening public works

For workers who lack other means to insure against unemployment risk, including a majority of informal sector workers, job creation via public works offers a good alternative. Evaluations show that public works programs

are effective in reaching the poor and alleviating short-term poverty. In addition, they are well-targeted to the poor, redistribute income from the rich to the poor, and provide flexible and fast response to shocks. On the downside, public works also suffer from several weaknesses—above all, high nonwage costs, and, in some countries, stigmatization of participants—that should be minimized via careful program design.

In designing public works programs, policymakers should be guided by several “good practice” principles. First, forgone earnings should be minimized by attracting workers with low alternative earnings opportunities. This can be accomplished by setting wages below the market wage level, to trigger a self-selection mechanism that will attract only those in need. Low wages also encourage participants to search for regular jobs and contribute to high labor intensity of selected projects.¹⁹ Second, displacement effects should be avoided by carefully selecting the types of public works projects. Third, to maximize the “bang for the buck,” programs should avoid projects that require heavy non-labor costs, particularly during crises. Fourth, public works programs should be more labor intensive than required by pure maximization of present value of the assets created. Labor intensity is determined by the selection of assets, the wage rate, and the ability of the implementing agency to account for nonwage costs.²⁰ Finally, exit strategies to facilitate the transition out of welfare dependency should be formulated (they could include wage subsidies, a combination of wage subsidies and skills training, and entrepreneurship schemes. (There is positive evidence of these programs in Argentina.)

The experience of the *Jefes de Hogar* (Heads of Household) project in Argentina stresses the importance of appropriate budgeting of non-wage costs. The program was designed to alleviate the impact of rising unemploy-

¹⁹ Although Korea and Thailand implemented similar public works programs during the economic crisis of the 1990s, labor intensity rates were significantly different: 70% in Korea and below 20% in Thailand. High statutory minimum wage prevailing in Thailand reduced the labor intensity degree of the program.

²⁰ While road construction projects tend to yield a share of wage to total cost of 40–50%, road and drainage maintenance projects as well as soil conservation and reforestation projects have a share of 70–80%. In some well-known examples, such as the Maharashtra Employment Guarantee Scheme in India, the wage bill represented 60–70% of total cost. In Argentina’s Trabajar program it ranged from 30 to 70%.

ment due to the worsening economic crisis in the early 1990s. It was shown to be effective in targeting the poor, with the number of participants in workfare activities estimated at around 1.5 million at its peak. However, the program has high non-wage costs, especially when managed by the local governments, and there is little evidence that it helps individuals in the long-run by providing them useful labor market skills.

Early retirement programs

Some countries may be tempted to use early retirement programs. These programs seek to facilitate the early withdrawal of older workers from the labor force by allowing for an early receipt of full or, more often, reduced pension benefits. They were introduced in industrial countries in the late 1960s in response to increasing unemployment and the deterioration of reemployment prospects for older unemployed workers. In the early 1990s, they were used in transition countries, where spending on early retirement by some countries reached 0.8% of GDP. A variant of early retirement programs is a job release program, which allows older workers to retire early and receive full pension benefits, conditional on employers replacing the early retiree with a younger unemployed worker. Moreover, countries sometimes relax unemployment insurance or disability rules for old workers to allow them to withdraw from the labor market early.

The early retirement route, however, is fiscally expensive and ineffective in promoting the employment of young workers. The example of Slovenia is instructive. The Slovenian government in the early 1990s subsidized early retirement, with women qualified for early retirement at the age of 50 and men at the age of 55, five years before their respective regular retirement ages (employers paid the missing pension credits and the government compensated employers for about 50% of the costs). But the program proved very expensive while failing to spur employment of young workers.

CONCLUSION

This note highlights specific labor-related programs which developing countries could resort to at times of crisis. It stresses that these responses should be tailored to the specific country circumstances and focus on labor

market groups that emerge most vulnerable during the crisis: young people, the low-skilled, women, older workers, and immigrants, and argues that in order to protect the employment and earnings especially in these groups, a set of well designed and targeted interventions should be put in place in a timely manner.

The current economic crisis should be seen by policymakers in developed countries as an opportunity for investing in new labor market programs or to improve existent features of on-going programs. For example, the note argues for the introduction of programs that provide a comprehensive package of training, income support, internship and re-employment services to deal with the multiple challenges workers are facing, rather than isolated programs, and such programs would surely prove beneficial also in normal times.

To monitor labor markets outcomes and to evaluate their programs, countries need to improve their information systems and monitoring and evaluation capacity. In many countries, labor market information systems, including regular monitoring of trends on the labor market through labor force surveys, need further improvement. Moreover, conducting special surveys such as tracer surveys of displaced workers would also be very useful. Governments should also invest in improving their monitoring and evaluation capacity. Such actions will not only allow them to respond to the need of rapid reporting, but they will also contribute to the rigorous evaluation of crisis programs.

The Economic Crisis and Mandatory Pension Systems in Developing Countries: Short- and medium-term responses for retirement income systems

SUMMARY

The international economic crisis has severely affected the value of pension fund assets worldwide. The unfolding global recession will also impose pressures on public pension schemes financed on a pay-as-you-go basis,

while limiting the capacity of governments to mitigate both of these effects. Governments are reacting to these events in different ways. Some are asking whether the balance between funded defined-contribution and unfunded pension schemes should be reconsidered. A few have already taken actions to reverse prior reforms. This note discusses the potential impacts of the economic crisis on fully funded and pay-as-you-go retirement-income systems in Bank client countries, and identifies key short- and medium-term policy responses. The note does not go into depth on the issues identified. Stand-alone technical notes will be prepared subsequently. This note itself will be updated and refined as new issues emerge. The main messages from the note can be summarized as follows:

- ❑ **Abrupt policy changes in response to the immediate circumstances should be avoided.** Pension systems are designed to function over long time periods. Poorly designed short term responses to relatively rare events can potentially have negative long-term consequences on the capacity of pension systems to reliably provide adequate levels of retirement income.
- ❑ **It is important to observe that only a small number of retiring individuals are affected by the crisis.** Targeted measures can be considered to mitigate the losses in their savings and the value of their pensions.
- ❑ **The current crisis strengthens the need for diversified multi-pillar pension systems.** These allow for a better diversification of risks and thus provide better protection to individuals who may be vulnerable to the kind of economic shocks now being experienced.
- ❑ **Increasing attention should be paid to managing the exposure of individuals to short term financial risks in funded systems. Strengthening the management of exposure** can be achieved through both default portfolios designed for workers nearing retirement age and also the development of phased transitions to the payout of benefits that limit the impact of short term financial volatility.

THE IMPACT OF THE ECONOMIC CRISIS ON FUNDED, DEFINED-CONTRIBUTION PENSIONS

The impact of the economic crisis on individuals participating in funded, defined-contribution schemes depends on four main factors: (i) changes in asset prices and the potential recovery over the medium term; (ii) the proportion of

pension wealth that is supported by funded individual account assets; (iii) the presence of minimum social pensions or guarantees that are integrated into the pension system; and (iv) the requirement and framework for mandatory annuitization of the accumulated balance at retirement.

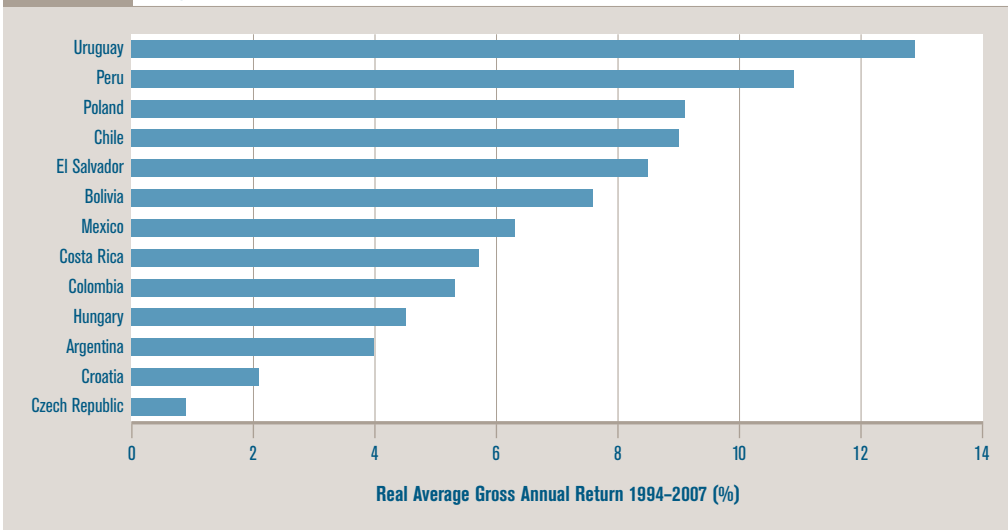
Losses in asset values over the last 12 months reported by pension funds have been considerable. In client countries with funded systems these losses have ranged between 8% and 50% (Table 2). While the losses are disturbing to plan members over the short term, they should not be taken as an indicator of the overall longer term performance of the funds which is the relevant perspective for any pension system. Indeed, from 1994 through 2007, in 13 countries for which data is available, the mandatory pension funds experienced an annual real rate of return of 6% per year (Figure 11). In Chile, for instance, even with the losses observed up to August of this year, real returns for 2002–2008 ranged from 3% to 10% a year depending on the type of portfolio. (AFP, 2008).

Most countries with mandatory funded pensions have multi-pillar systems in which funded individual accounts form only part of the overall retirement package. In a majority of countries, the pension individuals receive also has a defined-benefit component and often there are minimum pension guarantees (see below). All of the countries in Eastern Europe/Central Asia (ECA) except Kazakhstan that introduced funded schemes maintained a defined-benefit

TABLE 2 Real Returns of Mandatory Pension Funds (*year-on-year*)

		Growth	Balanced	Conservative
Chile	13–Oct	-46.1	-23.1	0
Mexico	30–Sept	-8.3	-6	-0.5
Peru	10–Oct	-47.8	-33.9	-14.5
Uruguay	30–Sept		-7.5	
Croatia	30–Oct		-14.1	
Estonia	15–Oct	-30.5	-20.9	-9.7
Hungary	15–Oct	-35		-18
Lithuania	15–Oct	-48.4	-32.6	-9.4
Poland	30–Sept		-17.4	
Slovak Republic	13–Oct	-12.4	-10.3	-2

Source: World Bank.

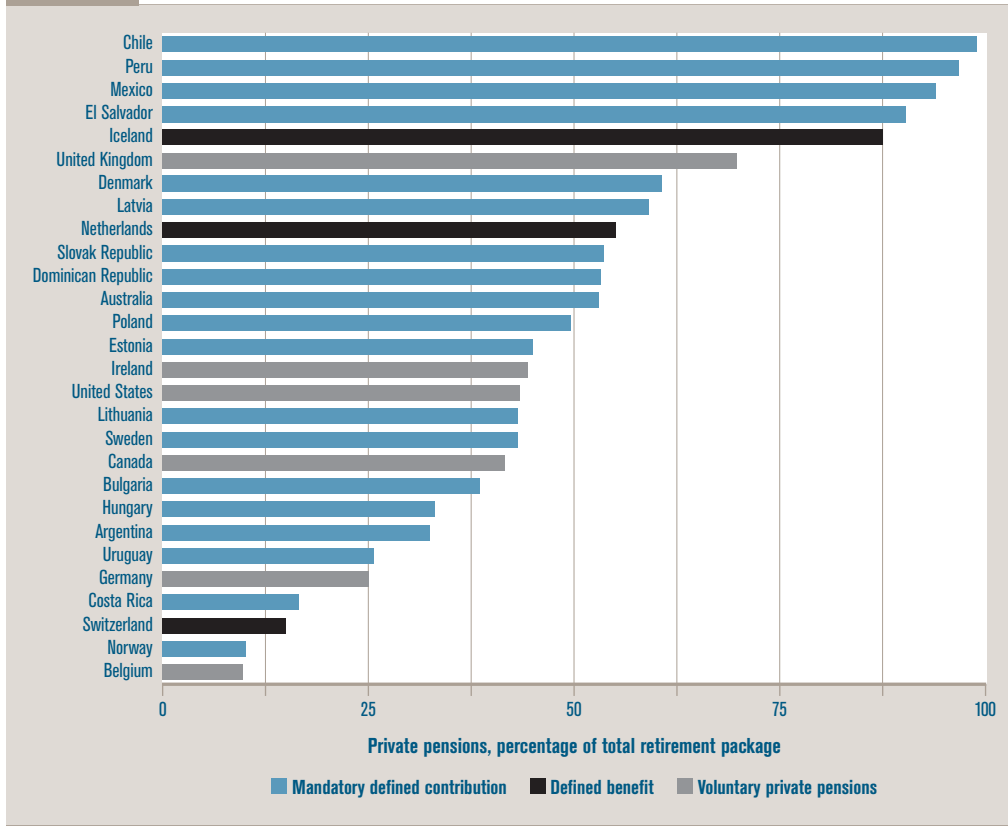
FIGURE 11 Long Term Pension Fund Returns

Note: For countries where the reform was implemented after 1994 (e.g., Croatia) the rate of return is from the point of inception.
Source: Bebczuk and Musalem (2009).

system as well. In Lithuania and Hungary, for example, less than 30% of the retirement benefit package for retirees today comes from financial assets in individual accounts. Retirement-income systems that are more exposed to the economic crisis include those of Chile, El Salvador, Mexico and Peru, where defined-benefit pension systems were eliminated and the majority of retirement incomes will come from funded defined contribution pensions (Figure 12). In Mexico, however, the government guaranteed that overall pensions under the new system would be at least as large as those under the pre-reform pay-as-you-go scheme for people already covered. The impact of the declines in asset values in Mexico will therefore be compensated for persons who retire before asset values recover.

Many countries also provide social pensions or offer minimum pension guarantees. The main objective of these provisions is to prevent poverty during old age. They are part of contributory or non-contributory (zero-pillar) systems. The average value of these benefits across countries for which information is available is around 30% of the average economy-wide earnings (Figure 13). As a result, even where pensions are heavily exposed to fluctuations in the value of financial assets, in many cases minimum pension guar-

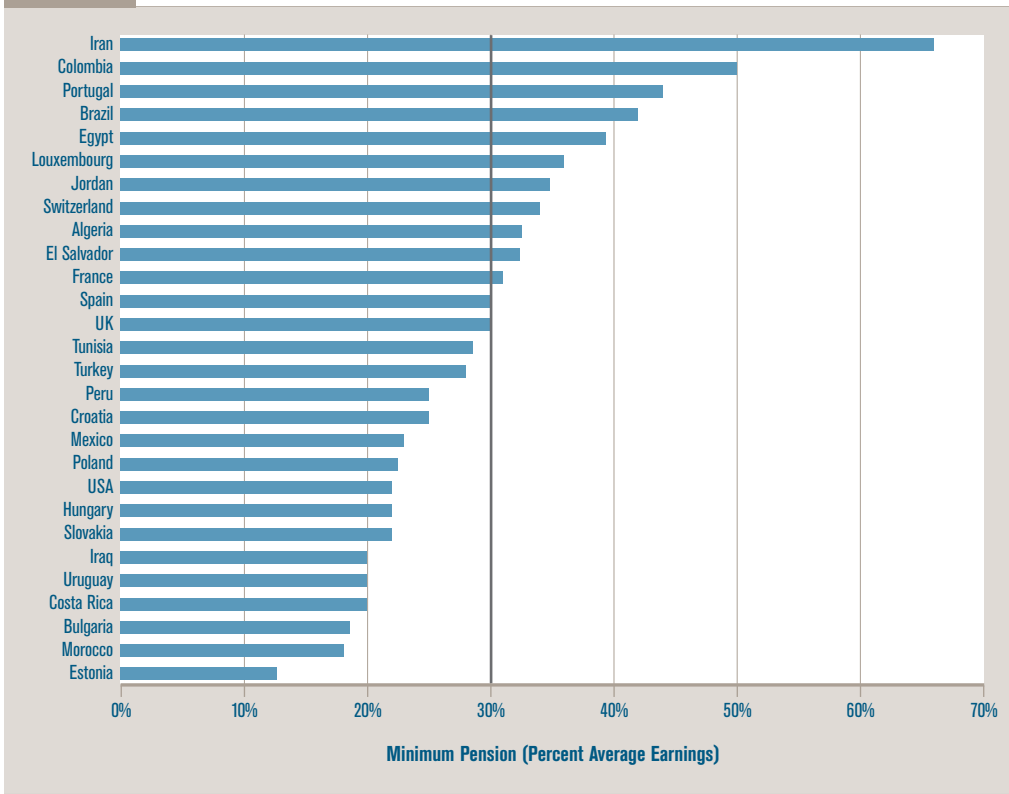
FIGURE 12 Role of Financial Assets in the Retirement Package



Note: Calculations are based on weighted average pension wealth and are for full-career workers. See OECD (2007) and D’Addio, Seisdedos and Whitehouse (2008).
Source: APEX model and Whitehouse (2007).

antees shield lower-income workers from poverty. Of course declines in asset prices can still materially reduce retirement benefits.

Only a small number of workers will retire during the period in which their pensions would be reduced due to the decline in asset values. Those workers facing the most urgent challenge are those who *have to* retire in the midst of the crisis and, in particular, those who are mandated to transform their accumulated retirement savings into an annuity. Most of the countries with mandatory funded systems have established these during the last 20 years, and typically included only workers who were more than 20 years from the normal retirement age. Although some permitted older workers to also switch into the funded system, except in a few countries, the participation

FIGURE 13 Minimum Pension Guarantees

Source: Staff calculations, Robalino et al. (2005), and Whitehouse (2007).

rates for older workers were not very high. Therefore there are relatively few individuals with a large reliance on a funded account who will be retiring in the short term.

The situation varies across regions. In the countries of Eastern and Central Europe and Asia (ECA) that reformed their systems beginning in the early 1990's the full cohorts will retire in 15 or more years and partial cohorts in 4 years. In Latin America, where reforms occurred earlier the situation is different as funded pillars already affect workers retiring now. But even in these cases there is a minority of plan members who are affected. For instance, in the case of Chile, the country with the oldest funded pillar, only 5% of plan members have to retire in the next 5 years and many other countries have a far lower percentage.

In addition, some funded systems have established multiple portfolios that include conservative options that are primarily invested in short term government debt. Although these portfolios provide a relatively lower rate of return, they shield plan members from most of the losses in asset values. In Chile, which introduced the multiple funds in 2002, older workers are limited to the more conservative funds one of which is a default option if they make no other choice. As a result 80% of the members within 5 years of retirement age are invested in one of the two most conservative portfolios and have been largely shielded from losses. Although small in number, if these retiring workers are severely affected, it will have a potentially important influence on the way in which the reformed pensions are perceived. It will also have a political influence well beyond the economic impact and so will likely need to be addressed in some manner.

ARE DEFINED-BENEFIT PAY-AS-YOU-GO PENSIONS AFFECTED AS WELL?

Earnings-related pay-as-you-go pension systems will be affected as the economic downturn reduces their stream of revenue and potentially increases benefit claims. Indeed, the emerging global recession will reduce contribution revenue in most countries as a result of decrease in employment or reductions in the level of earnings on which contributions are levied. In addition, pension expenditures from such schemes will likely increase as more individuals retire from the labor force and seek pension benefits in the face of an economic downturn. Disability claims can also increase in response to higher unemployment.

The extent of the financial impact depends significantly on the maturity of the scheme. Countries which will face the greatest fiscal pressures are those where financial flows from contributions and investments are less than current expenditures, and those where liquid reserves could face the greatest fiscal pressures. Examples of countries in this situation include: Azerbaijan, Brazil, Egypt, Morocco, Russia, Serbia, and Tunisia. Those countries in a less frail financial situation will need to reduce cash balances temporarily and/or draw on reserves. However, it should be possible to repair the effects once the crisis has passed.

The effects on members will depend on how governments deal with the shortfall in revenues. They could finance pension-scheme deficits in full. Alternatively, they might partially default on pension promises, by delaying pension payments or failing to index benefits, for example. The balance between the two options will be politically determined as pensions are just one of a range of competing demands for limited public resources. The main difficulties will be observed in countries that have overall fiscal deficits and rely on external debt financing that has become increasingly difficult to refinance with the global credit crunch.

In some cases, countries that have introduced funded second pillars may be tempted to re-allocate the portion of the social insurance contributions that previously went to pay-as-you-go schemes back to the public schemes. This recently occurred in Argentina. Although this might address short-term cash flow issues, it does not improve the overall public net-liability position, and it risks having negative long-term consequences on the individual benefit position. In addition to diminishing the diversification of the overall retirement system and placing workers at the risk of future benefit reductions if the system cannot remain viable over the long term with the increased liabilities, this will also close funded accounts when asset values are low, locking in losses and precluding members from the opportunity to benefit from any recovery in prices.

SHORT-TERM RESPONSES

In the short-term, governments are advised not to overreact to current economic conditions and to carefully analyze the full consequences of policy responses in the context of the long-term planning horizon relevant for pensions. Three general recommendations are made.

First, governments should avoid short-term reform reversals that have not been properly assessed and that may come at a high price for future retirees. Reverting workers more than five years from retirement to a pay-as-you-go system may be attractive and politically expedient. However, this implies that government would be reinstating an implicit pension liability with the pay-as-you-go

system (in exchange for the assets they borrow now) and that will need to be financed in the future. Limiting contributions to funded systems in the current period will also deny members the opportunity to receive higher pensions in the future. This is particularly true now when plan members could purchase assets at relatively low prices and thus accrue large potential gains.

Similarly, moving asset allocations to what are perceived as more secure instruments such as short term government debt may placate members with diminishing accounts but will severely limit the opportunities for higher retirement benefits. Analysis of historical patterns in the asset markets of developed countries demonstrates that, despite significant variation in rates or return due to market volatility, a diversified portfolio of assets would result in a higher level of retirement savings over nearly all time periods.

Secondly, governments should recognize that the current economic crisis is a rare “extreme” event. As such, it requires temporary measures to deal with the effects of the crisis rather than structural changes in policy. Moreover, any compensation arrangements that may be considered need to be carefully designed. Once established these could be very difficult to eliminate even when conditions no longer warrant them.

Thirdly, governments should not underestimate the potential positive effects that long term institutional investors (such as pension funds) can have on the financial system enterprise financing, and ultimately employment and growth. Countries with well-developed, regulated and supervised pension funds (such as Chile) have been able to weather past shocks much better as the purchase of commercial bonds partially compensated for reduced access to Bank loans. There is emerging evidence that pension funds are moving into loan markets previously dominated by commercial and investment banks (such as in the Netherlands).

The following short-term measures should be considered:

- ❑ **Launch a public information campaign** to explain the situation to members of funded and defined-benefit pension schemes, informing the public of the volatility of investment returns, providing detailed information on the actual and anticipated effect on benefits for workers of different age

groups, and describing measures such as minimum and/or non-contributory pensions to protect the poorest and most vulnerable. Such an effort would ideally be undertaken in any event in order to improve the understanding and financial capability of workers that will have beneficial long term effects beyond the pension system. The current crisis can provide the impetus for such an effort and creates an ideal opportunity for it to be effective as workers are more attentive to financial issues.

- ❑ **Establish a framework for phased or deferred annuitization or the alternative of receiving benefits through phased withdrawals on reaching retirement age.** This is important for those funded schemes with mandatory annuitization. As discussed above, the individuals most at risk from the rapid decline of asset values are those very close to retirement who potentially lock in the large declines when they convert their savings into an annuity. Allowing for phased withdrawals and the gradual purchase of annuities can enable individuals to realize the effects of an eventual recovery by not requiring the liquidation of invested assets until their value has some time to recover.
- ❑ **Consider a limited and time-bound support program for the small group retiring in the midst of the crisis that will be most affected.** Indeed, there are some, primarily, low-income workers with lower saving levels who might, even under a phased annuity purchase or withdrawal program, be required to liquidate their diminished accounts in the short term. This group could be assisted through programs that offer a minimum return guarantee, analogous to what has been provided in the banking system in response to the crisis. This help should be accessible only to people close to retirement and targeted by level of income. The principle would be to compensate individuals facing a major decline in *net* replacement rates. Such an effort would then be phased-out as the recovery reaches certain trigger points. In all cases, however, the opportunity costs and distributional effects of the public resources involved should be carefully assessed.
- ❑ **Help pay-as-you-go systems to remain financial viable and protect the benefits of low-income workers.** As suggested above, in many cases the government may need to provide additional financing for public pension schemes to replace a decline in the collection of workers contributions. Government could also consider options to maximize protection of low-income workers facing declining salaries by offering

flat-rate minimum pensions and full indexation of benefits. Any such effort should bear in mind, however, that many pay-as-you-go pension systems cover only the wealthiest minority of the labor force and that such support could come at the expense of other more vulnerable groups not covered by the formal pension system.

- ❑ **Reconsider the valuation rules applicable to pension fund assets in the context of the extreme current volatility in financial markets.** There has been a current, and largely beneficial, trend toward requirements for mark-to-market valuation of the assets of all types of financial institutions including pension funds. While this generally increases transparency and the value of disclosure there may be circumstances, such as the current crisis, in which it proves to be counterproductive. Regulators and supervisors may consider relaxing these rules to smooth presented valuation when extreme short term price movements occur. Some smoothing in periods of extreme volatility more accurately reflect the true underlying values and avoid the possible adverse reactions to large changes that prove to be very short term.

MEDIUM-TERM RESPONSES

The economic crisis provides a strong impetus for all countries to review the design and implementation of policies to best achieve the core objectives of retirement systems. It particularly highlights the value of diversification in the overall system design and the need to effectively manage the risks associated with funded arrangements. Over the medium term, attentions should be given to the following issues:

- ❑ **Better diversify the management of financial and other macroeconomic risks.** The economic crisis strengthens the case for a multi-pillar pension system, which can be highly resilient in the face of even severe financial and economic turbulence. The multi-pillar system would incorporate elements of a well targeted social pension or minimum guaranteed benefit (a zero pillar) to ensure broad protection against poverty; a sustainable earnings based first pillar, and funded second pillar. The three operating together would provide core benefits to the broad population even during the low points of the economic cycle. Key questions

for governments will be: (i) how to set the level of the basic pension and its eligibility conditions to; and (ii) how to allocate the contribution rate between the first pillar (more exposed to labor market risks) and second pillars (more exposed to financial risks).

- ❑ **Improve the management of financial risks.** For the funded (second and third) pillars, the crisis should prompt renewed attention on the importance of well developed risk management and governance standards and integrating these into the regulation and supervision of pension funds. In addition, mechanisms to better shield retirees from the impact of account fluctuations immediately before retirement should be explored. These could include the introduction of age based/life-cycle portfolios which require low- and middle-income workers to switch part of their balances to less risky investments as they get closer to retirement. Default age- and earnings-related asset allocations are also important in light of the observed inertia of contributors.
- ❑ **Make pay-as-you-go systems more sustainable, robust and secure.** For the first pillar, countries should consider the adoption of Notional Defined Contribution schemes where benefits are linked to contributions and life-expectancy at retirement. Ideally, these systems would incorporate a reserve fund and an appropriate balancing mechanism to adjust to demographic and economic developments. At the minimum, countries with traditional defined-benefit systems should introduce changes in benefit formulas and eligibility conditions to: (i) gradually incorporate all salaries in the calculation of the pension, with past salaries indexed by the growth rate of the average covered wage; and (ii) link the calculation of the accrual rate to the retirement age and the contribution rate. If these two measures are adopted countries can also consider the automatic indexation of pensions.
- ❑ **Have a well-designed zero pillar where affordable and justifiable.** A well-designed zero pillar or the incorporation of a minimum pension guarantee into one of the other pillars can mitigate the effects of future economic volatility on the vulnerable elderly and lifetime poor. These systems need to be carefully designed to ensure their affordability and that they do not have negative incentive effects
- ❑ **Integrate unemployment savings and insurance options into an overall social insurance system.** Pension systems can become de facto unemployment insurance systems in period of economic disruptions as

workers losing their jobs seek to claim retirement or disability benefits when other alternatives are not available. Some countries need to consider stronger restrictions on disability claims and early retirement, while strengthening the income-protection systems for workers who lose their jobs. Policy options include combinations of unemployment insurance and unemployment individual savings accounts that can be accessed during spells of unemployment.

CONCLUSIONS AND RECOMMENDATIONS

- ❑ The impact of the economic crisis extends beyond immediate losses to pension fund assets.
- ❑ Abrupt policy changes in response to the immediate circumstances should be avoided. Pension systems are designed to function over very long time periods. Short term responses to relatively rare circumstances can potentially have negative long term consequences on the capacity of pension systems to reliably provide adequate levels of retirement income.
- ❑ Measures to mitigate the effects on the relatively small number of retiring individuals can be considered without fundamentally altering the system design.
- ❑ The current crisis strengthens the need for diversified multi-pillar pension systems that are able to manage risks and provide protection to individuals who may be vulnerable to the kind of economic shocks now being experienced.
- ❑ Increasing attention should be paid to managing the exposure of individuals to short term financial risks in funded systems through portfolios designed for workers nearing retirement age and the development of phased transitions to the payout of benefits that limit the impact of shorter term financial volatility.

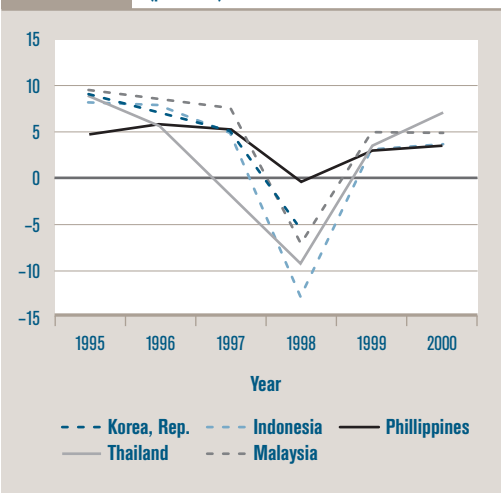
Appendix: How East Asian and European Transition Countries Reacted to Economic Shocks

EAST ASIAN COUNTRIES

The shock and the labor market impact. The precipitous decline in economic growth during the recent East Asian economic crisis (Figure A1) increased unemployment and reduced wages. Interestingly, while employment decreased in some countries, it increased in Indonesia and the Philippines (the so-called added worker effect). In the worst-affected countries of Indonesia, the Republic of Korea, and Thailand, the unemployment pool increased by about a million workers in each country. Between 1997 and 1998, the unemployment rate soared from 2.6 to 6.8% in the Republic of Korea and from 2.2 to 5.2% in Thailand, while Indonesia and the Philippines showed small increases. The effects of the crisis on marginal groups were severe—survey evidence showed that the poor in the Philippines reacted by taking their children out of school, working longer hours, and migrating to urban areas or other countries. Similarly, in Indonesia, poor households reduced the share of consumption on education.

Beegle, Frankenberg, and Thomas (1999) report in detail about labor market adjustments in Indonesia. Wages took the brunt of the adjustment, with median wages falling 20–30% between 1997 and 1998, with even larger declines for men and urban workers. While men's employment remained unchanged, women's employment rose, primarily because more women worked as unpaid family workers. Fewer men, but not women, held secondary jobs in addition to their primary job, and average working hours for both men and women increased. Younger workers had better access to jobs than older

FIGURE A1 Annual GDP Growth Rates in Selected East Asian Countries, 1995–2000 (percent)



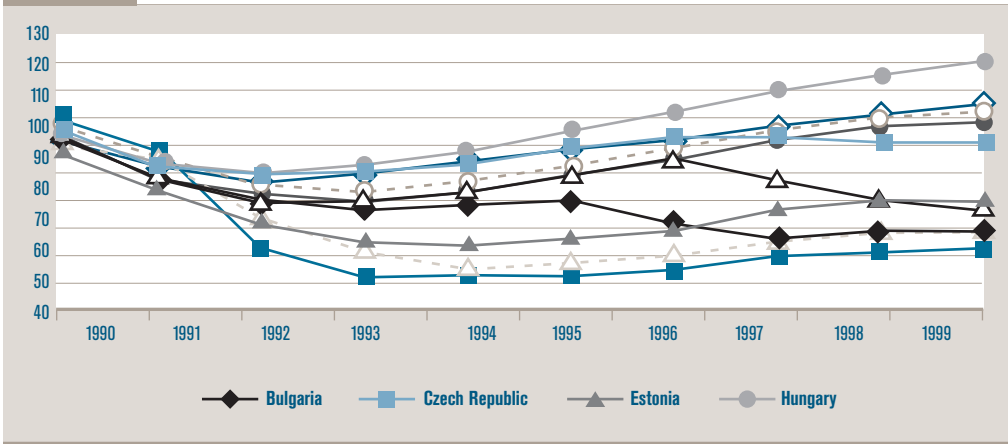
workers, and men in rural areas had better access than men in urban areas. Younger, better-educated, and urban residents were also more likely to have moved between 1997 and 1998.

Labor market policy response. The response to the crisis was similar across the worst-hit countries, with governments resorting to both employment-generation and income-maintenance programs. Most countries adopted large-scale, labor-intensive public works programs as emergency measures. These programs involved 2.2% of the labor force in Indonesia, 2.6% in the Republic of Korea, and 5.2% in Thailand. Other programs were also introduced. Indonesia provided subsidized credit to small-scale firms and cooperatives. The Republic of Korea introduced job preservation and hiring subsidies to assist firms in dire circumstances. Indonesia, the Republic of Korea, and Thailand all created programs to promote self-employment.

Some changes were made in job security legislation to help displaced workers. In both the Republic of Korea and Malaysia, laws were amended to entitle workers who quit voluntarily to severance pay. But failure to remit severance pay was a problem. In Malaysia employers disbursed only 83% of the claims of laid-off workers in 1998. Compliance was also low in Thailand, particularly among small employers. To address the problem, the Republic of Korea and Thailand introduced guarantee funds, which financed unmet claims from workers whose enterprises went bankrupt. Other legislative changes to extend income protection in Korea included widening public unemployment insurance coverage to smaller firms (those employing five workers or more). The Philippines introduced the Emergency Loan Facility for Displaced Workers, which lets workers borrow based on their previous payments of social security contributions. The program resembles UISA programs in Latin American countries.

EUROPEAN TRANSITION COUNTRIES

The shock and the labor market impact. Reforms in transition countries in the early 1990s drastically reduced output and employment. Output decline was related largely to supply side shocks and structural imbalances that had accumulated for decades under the socialist regime. The cumula-

FIGURE A2 Evolution of GDP in European Transition Countries, 1989–99 (1990 = 100)

tive decline in GDP was about 25–35% in Central and Eastern European countries and about 40–50% in the Baltic republics. Reductions in output invariably reduced employment and increased the number of unemployed and the number of inactive people. Due to the low probability of exit from unemployment, long-term unemployment—particularly prevalent among the unskilled—also became a serious problem, as did youth unemployment. The incidence of poverty among households with an unemployed member rose to twice that among households with no unemployed member.

Labor market policy response. The responses of countries to the emergence of large-scale unemployment varied. To assist the unemployed, all countries introduced new labor market programs, both income support programs and active labor market programs. But—partly because they had not experienced open unemployment before—these countries also introduced policies aimed at reducing inflows into unemployment, such as job preservation subsidies and government-sponsored retrenchment programs (that subsidies re-training of workers and early retirement).

In overhauling their cash benefit programs, European transition countries followed the blueprints of the European Union welfare states. Most important, they added two new programs, unemployment insurance and/or assistance and social assistance, to their existing programs of severance pay, family benefits, and pensions. In most countries, overall expenditures on

unemployment benefits were less than 1% of GDP; in a few countries—Hungary, Poland, and Slovenia—they exceeded that level.

In addition, all transition countries maintained active labor market programs, including training, special measures for young people, employment subsidies, public works, and support for self-employment. With the exception of Hungary and Slovenia, the level of active support (0.15–0.30% of GDP in most countries) was much lower than in OECD countries. Hungary spent considerable resources on training and Slovenia on job preservation subsidies (a record 0.7% of GDP in 1992). In many transition countries, public works have proved mostly to be a way of providing income to the needy rather than a vehicle for increasing the employability of the unemployed.



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