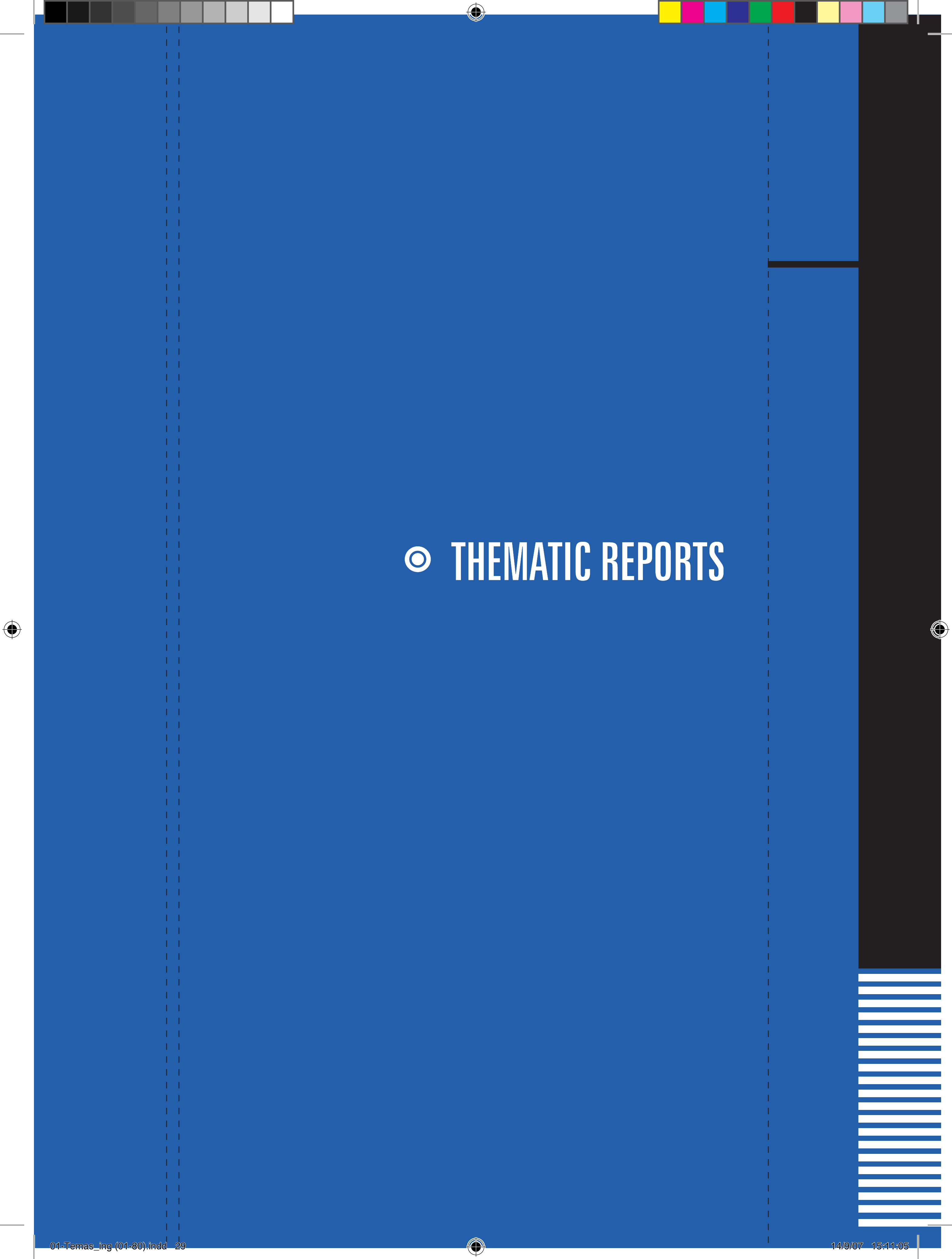

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Betting on the risks of the poor: The World Bank's approach to social security

The World Bank has demonstrated peculiar persistence in promoting privatized social security systems. Even when studies carried out by the Bank itself indicate that it is not possible to prove the success of these reforms, privatization policies for old age pension systems have been consistently implemented since the1980s. This approach, currently labelled 'social risk management', claims to complement existing social protection systems. However the role of governments is limited to compensating for the market's failings.

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Campaign to Reform the World Bank

Since the 1980s, World Bank-driven structural reforms have systematically shifted the balance of social risk away from state institutions and onto the shoulders of the individual. For example, the World Bank's policy objective of prioritizing financial system restructuring and development has increasingly targeted the reform of public social security institutions, involving the privatization of old age pension systems. This significantly heightens the longevity risks faced by individuals, in particular by reducing the role of risk pooling and by making individuals increasingly responsible for having sufficient personal savings to cover consumption needs for the duration of retirement.

In 12 Latin American countries, beginning with Chile in 1981, purely defined-benefit, 'pay as you go' public pension systems – in which the pensions paid to the elderly are financed by contributions paid by current workers – have been substantially downsized, and mandatory individual savings accounts and voluntary pension plans have been added in a process known as the 'multi-pillar approach' to pension reform.

The single-mindedness of the World Bank in promoting privatized systems has been peculiar, since the evidence – including data in World Bank publications – has indicated that well-run public sector systems, like the social security system in the United States, are far more efficient than privatized systems. As a matter of fact, the extra administrative expenses of privatized systems comes directly out of the money that retirees would otherwise receive, lowering their retirement benefits by as much as one third, compared with a well-run public social security system.

The administrative expenses that are drained out of workers' savings in a privatized system are the fees and commissions of the financial industry, which explains its interest in promoting privatization in the United States and elsewhere. For instance, US firms like Merrill Lynch have been some of the biggest beneficiaries of social security privatization in developing nations such as Chile.

The World Bank has been quite successful in promoting this neoliberal approach in the field of social policy, thus entering a field of public action largely dominated until the mid-1990s by a UN specialized agency, the International Labour Organization (ILO). The opportunity was offered by the critical evaluation of the continuing universal appropriateness of ILO Convention 102 on minimum standards in social security, signed in 1952.

Specifically, conventional contributory approaches to social security provision, as defined by this Convention, are inherently unsatisfactory mechanisms for the financing and delivery of social protection to the large majority in the least-developed countries. In particular, low levels of population coverage – around 10% against 80% in industrialized countries – continue to undermine the legitimacy of mandatory contributory schemes. It is estimated that the problems of chronic poverty, and the insecurity which this brings, affect more than three quarters of the world's population who have no access to formal social security programmes, including more than one third of the world's population who currently remain without any form of social protection at all.

The attack on public social security

The World Bank's rapid displacement of the ILO from its traditional role as the institutional repository of knowledge in the field of social protection policy, and in particular old age pension provision, is actually rather ironic. It should not be overlooked that a contributory factor in the failure of conventional social security mechanisms to provide more adequate levels of coverage in the developing world has been the detrimental impact that the neoliberal-inspired, anti-state policy agendas of World Bank structural adjustment programmes (SAPs) have had upon levels of formal sector employment in adjusting and transition economies.

The World Bank's attack on public sector social security systems around the world has been both direct and indirect. The indirect attacks have been most important for industrialized countries like the United States. The World Bank has vigorously promoted the notion that social security systems, such as the one in the United States, are unsustainable. This was done most clearly in a decisive World Bank book on pension reform published in 1994, *Averting the Old Age Crisis*.[1] The title implies that longer life spans, due to increasing wealth and improved medical technology, are going to impose an unbearable burden on nations, unless their social security systems are radically altered.

This basic premise of the book has been widely criticized.[2] Life spans have been increasing rapidly in the industrialized nations for more than a century. In most industrialized countries – including the United States – the increase in spending on social security programs in the past 30 to 40 years was actually larger (measured relative to the size of the economy) than it is projected to be in the next 30 to 40 years. In other words, the World Bank could have more appropriately written *Averting the Old Age Crisis* in 1960 than in 1994.

The lack of evidence to support its basic premise has not prevented *Averting the Old Age Crisis* from being extremely useful to political groups with an interest in privatizing social security systems around the world. It is worth noting that Estelle James, who led the research team that authored *Averting the Old Age Crisis*, is now a member of George W. Bush's presidential commission for privatizing social security, although not in her capacity as a World Bank employee.

The World Bank's role in promoting the privatization and structural reforms of social security systems in the developing world has been far more direct. In addition to providing rhetorical support to the ideological and financial interests who advocate privatization, the World Bank has also provided loans and technical assistance to nations that have privatized their social security systems, particularly in Latin America and the Caribbean, and also later in Eastern European countries.[3]

However, in 1999 the first critical voices started emerging within the Bank concerning its ideological approach to structural reform of pension systems. In particular, the World Bank chief economist at the time, Joseph Stiglitz, sought to alter the Bank's single-minded support for privatized social security systems, co-authoring a paper which pointed out that many of the reasons given for preferring privatized social security systems are not supported by evidence. He openly encouraged the institution to rethink its approach on the subject

1 World Bank (1994). *Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth.* Washington DC: Oxford University Press.

2 Baker, D. (2001). *The World Bank's Attack on Social Security.* Washington DC: Center for Economic and Policy Research.

3 See chapter about World Bank policies in Central-Eastern Europe developed by the BGRF and BEPA in this Report.

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by critically dismantling ten myths about social security systems.[4]

While acknowledging that the problems that had motivated pension reforms across the globe were real, Stiglitz noted that the arguments most frequently used to promote individual retirement accounts are often not substantiated in either theory or practice. The study therefore concluded that "policymakers must adopt a much more nuanced approach to pension reform than that offered by the common interpretation of *Averting the Old Age Crisis*." Furthermore, Stiglitz made it clear that the one-size-fits-all approach promoted by the Bank until then could not fit the very different contexts and situations in so many countries around the world.

The new 'social risk management'

In order to react to these criticisms and address concerns about the coverage limitations of formal and semi-formal contributory social protection systems, the World Bank conceptualized its new approach to social protection, the so-called social risk management (SRM) approach. In 2000, the World Bank's World Development Report presented its new policy framework for "attacking poverty" (which was also the title of the report). Significantly, at the time of the definition of the Millennium Development Goals[5] in the UN Millennium Declaration, the Bank clearly stated its intent to reconceptualize social policy as social risk management.

Framed conceptually using the common shared terminology of risk management and commercial insurance, and drawing upon assets-based approaches to welfare, the stated core policy goal of SRM is the alleviation of hard-core poverty through the better management of risks, defined in an inclusive sense to cover social, economic, political, environmental, labour market and non-labour market hazards or risk events.

Social risk management has been presented as having dual roles: protecting basic livelihood and promoting risk taking. As such, the SRM approach to social protection clearly differs from conventional social policy approaches, under which the rationale for social policy intervention is explained by issues as varied as market failure, solidarity and mutual obligation. In short, through emphasizing the double role of risk management instruments, SRM aims to empower the chronic poor with a greater ability to mitigate predicted labour market and non-labour market risks through increased access to a diversified range of assets, while simultaneously encouraging greater (entrepreneurial) risk-taking behaviour.

Once again, SRM aims at reducing the role of risk-pooling state provision while encouraging a greater role for private sector delivery of individual risk mitigating instruments. The significance of this element of the SRM approach is that, by prioritizing the private sector delivery of individual risk mitigating instruments, those individuals without sufficient financial means to purchase commercial insurance products are more likely to have to tolerate greater degrees of risk. Therefore the overall aim of the new approach is the lessening of risk, not the meeting of needs.

In general, the concern with the SRM approach, and in particular its explicit desire to further limit the scope of formal social security, is that a greater number of individuals are likely to become increasingly reliant upon public 'safety net' coping mechanisms, albeit complemented by additional informal, and potentially illegal, coping strategies. Surely, an effective system of social risk management should reduce the need for coping strategies, and not enhance it. Such a situation is clearly undesirable, and in fact runs contrary to the neoliberal mantra of increasing individual empowerment by reducing dependence on state institutions.

A similar degree of uncertainty remains with regards to the SRM expectation that asset ownership will encourage successful risk taking. Within the SRM framework, the assumption is made that if the poor could engage in riskier and thus potentially higher-return activities, then this would enable these individuals to graduate out of chronic poverty. Suggesting that the poorest, for lack of assets and social capital, shy away from "engaging in riskier but also higher return activities"[6] seems rather inappropriate and overgeneralized.

What is the state's role in fighting poverty then?

A key problem encountered in analyzing SRM lies with the difficulty in delimiting the parameters of state action. In general, and despite the stated intent of SRM to complement existing social protection systems, the 'repositioned' social protection role of government is presented in a somewhat prescriptive and limited fashion as a means only to compensate for market failure. For instance, Holzmann and Jørgensen[7] refer to the role of government as "providing risk management instruments where the private sector fails" or as "enacting income redistribution if market outcomes are considered unacceptable from a societal welfare point of view." However, the Bank's limited expectations regarding the desired role for governments in social protection provision is presented most clearly when they suggest that the state should provide "social safety nets for risk coping."

The emphasis placed by the Bank on coping strategies suggests that the SRM framework is built upon two premises. First, there is a premise that state institutions in developing countries will never be in a position to provide anything other than the most limited forms of social protection. Problematically, this perspective appears to deny the possibility of social progress. Second, the SRM framework appears to have been built upon the premise that developing countries should actively seek to implement social protection strategies which limit state action to the delivery of targeted social expenditure only.

These assumptions have serious implications for the most vulnerable groups in society. For the elderly poor, SRM may prove to be doubly problematic. On the one hand, poor elderly people, especially in the least-developed countries (LDCs), are progressively more likely to become marginal players in labour markets and household economies as they age. On the other hand, they are also progressively less likely to have access to 'assets' which can be used to mitigate against predicted or unpredicted risks. Accordingly, part of the solution to the problem of poor levels of social protection coverage for older people in the LDCs in particular must lie with the universal provision of tax-financed cash benefits – something which has been highly criticized by the Bank.

Providing for the elderly in developing countries should be seen as something of strategic importance within social and economic development programmes. It is increasingly recognized that older people have an important role to play within extended family groups in helping to reduce the destabilizing outcomes of increasing urbanization, labour force migration and, in Southern Africa in particular, the debilitating impacts of HIV/AIDS. This is because the family has traditionally been the most important, and sometimes only, social protection mechanism available to many people in the developing world. Therefore, providing older people with 'assets' in the form of cash benefits will guarantee that they have a continuing value as caregivers for family and community members.

Finally, it remains to be seen whether SRM approaches to social protection can provide a framework to lift people out of poverty in the longer term. From a conceptual perspective, the SRM framework relies too heavily upon the need for coping strategies for it to satisfactorily fulfil its self-proclaimed role in the management of social risk. For marginalized,

4 Orszag, P. (Sebago Associates, Inc.) and Stiglitz, J. (World Bank) (1999). "Rethinking Pension Reform: Ten Myths About Social Security Systems". Presented at the conference on "New Ideas about Old Age Security", 14-15 September. Washington DC: World Bank.

5 See details of the MDGs in Joyce Haarbrink's article in this Report.

6 Holzmann R. and Jørgensen S. (2000). "Social risk management: a new conceptual framework for social protection, and beyond". Social Protection Discussion Paper No. 0006. Washington DC: World Bank.

7 *Ibid.*

poor older people, with no access to either labour market opportunities or alternative risk mitigating assets, the only feasible institutional mechanism for social protection remains the state. Therefore, the development of policies prioritizing a strategic role for tax-financed universal pension provision in LDCs would provide a more immediate mechanism to help mitigate life-cycle risks and to help lift older people out of poverty.[8]

The facts speak: the failure to extend pension coverage

Ten years after theorizing its extreme approach to pension reform in *Averting the Old Age Crisis*, the World Bank carried out a preliminary review of its experience in pension reform in Latin America, with some surprising findings.[9]

According to the Bank, Latin American governments that had undertaken structural overhauls to their national pension systems had improved their budget position, made public pensions more equitable, and encouraged savings and investment. But Guillermo Perry, World Bank chief economist for Latin America and the Caribbean, openly admitted that "...the failure to extend coverage to a broader segment of society makes it premature to call the reforms a success. Old age poverty remains a significant risk for the region's citizens."[10] Furthermore, the World Bank study pointed out that "more than half of all workers [are excluded] from even a semblance of a safety net during their old age."

In the specific case of Chile,[11] it was found that the investment accounts of retirees were much smaller than originally predicted – so low that 41% of those eligible to collect pensions continued to work. Voracious commissions and other administrative costs had swallowed up large shares of those accounts (up to 50%), and the transition costs of shifting to a privatized system were far higher than originally projected, in part because the government was obligated to provide subsidies for workers failing to accumulate enough money in their accounts to earn a minimum pension.

PRIVATIZING SOUTHERN EXTERNAL DEBT

Andrea Baranes (Fondazione Culturale Responsabilità Etica, Social Watch Italy)

The external debt of many countries in the South, and notably some of the poorest in the world, has held back development, the fight against poverty and the financing of social security in those nations for more than 30 years.

Northern governments and international financial institutions like the World Bank and the International Monetary Fund (IMF), which are primarily responsible for this unsustainable situation, have repeatedly declared their willingness to free the poorest countries from the burden of this debt and the need to find a proper solution. Up until now, however, the declarations made and initiatives formulated, such as those arising from the G8 Summit in Gleneagles in 2005, have yielded poor results, if any.

Now the poor and highly indebted countries are facing a new threat, as they are obliged to deal with new creditors that pay even less attention to their needs and requests: private financial institutions.

In the last few years, an increasing part of the external debt owned by export credit agencies (ECAs), private banks and in some cases even Northern countries has been sold onto secondary financial markets, and is now controlled by highly speculative institutions such as private equity funds and hedge funds.

The mechanism by which this debt has flown from publicly controlled institutions like ECAs to speculative markets is called securitization, an instrument by which one financial institution sells risky credits at a discounted price to another financial company or to the secondary financial market.

After this process has taken place, it is now very difficult, and in some cases almost impossible, to know who controls a significant part of some of the poorest countries' external debt. As a result, any future initiatives undertaken at the international level to eliminate a part of this debt could be seriously thwarted by these new financial mechanisms.

Many countries in the South must now contend with this new threat to the fulfilment of fundamental social and human rights. The securitization and privatization of debt is just one of the financial mechanisms generating severely adverse impacts on the poorest inhabitants of the planet. There is an urgent need to draw up and enforce adequate national and international rules to regulate and control financial and economic powers, in order to bring them back to their original role: helping people to improve their lives, instead of seriously threatening them. ■

However, the Bank limited its self-criticism to the need to improve market-based mechanisms in order to fix outstanding problems in a privatized system, and in particular to pay more attention to ensuring that privately administered pension plans are efficient by offering affiliated workers and their families the best possible coverage at competitive prices. By doing this, the Bank avoided answering the original question which drove it into the social security reform business in the first place: the question of how to extend coverage to the elderly poor. Nevertheless, it finally recognized after a decade that governments should be paying much more attention to the poverty-prevention function of national pension systems.

The World Bank's controversial new health strategy

The SRM framework and its flawed assumptions are also at the heart of the World Bank's approach in the case of the 10-year Health, Nutrition and Population Strategy elaborated in 2006, which consequently presents an incorrect diagnosis and therefore an incorrect prescription for reform.[12]

Once again – as in the case of social security policy and the ILO – the Bank cooperated very little with the World Health Organization (WHO) and neglected most of the research, policy advice and technical assistance already offered by this institution to developing countries' governments. The biased selection of research and analysis that underpins the proposed new health strategy is moving the Bank to further exacerbate existing shortages of health workers, to further undermine public health systems, particularly in low-income countries, and to entrench two-tiered systems where the poor will continue to be denied access.

8 McKinnon, R. (2004). "Social risk management and the World Bank: resetting the 'standards' for social security?", Journal of Risk Research 7 (3), April. Carfax Publishing.

9 Gill, I., Packard, T. and Yermo, J. (2004). *Keeping the Promise of Social Security in Latin America*. World Bank and Stanford University Press.

10 World Bank (2004). "Keeping the Promise of Old Age Income Security in Latin America". Press release, 13 December. Available from: <wbln1018.worldbank.org/LAC/LAC.nsf/PrintView2ndLanguage/146EBBA3371508E785256CBB005C29B4?Opendocument>.

11 Anrig Jr., G. and Wasow, B. (2004). "Twelve Reasons Why Privatising Social Security is a Bad Idea". The Century Foundation.

12 Oxfam Great Britain (2007). "World Bank Health Strategy and the Need for More Balanced Research and Analysis Across the Bank". Briefing prepared by Oxfam for Civil Society Organizations. EU World Bank Executive Directors meeting, Brussels, 6 February.

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The analysis that has been done by Bank staff for the new health strategy assumes that existing levels of out-of-pocket payment are an indication of ability and willingness to pay for services. This is despite research quoted in the very same document which demonstrates that these existing payments have driven millions of marginalized people into deep poverty.

The analysis further proposes an increase in the contracting-out of health services to the private sector and the promotion of social insurance systems. This diagnosis takes the current situation as a given for the future and does not look for ways to improve public system capacity. For example, it does not address the acute shortage of health workers overall – according to WHO, 4.2 million more physicians, nurses and support workers are needed around the world. Nor does it address public sector capacity to coordinate, regulate, and harmonize sustainable and robust health care systems. By doing this, the Bank approach ignores a large, if not overwhelming, body of evidence that low-income countries with weak state capacity are not able to effectively regulate and incentivize private health providers to offer equitable access to services for all. Instead, they need precisely the opposite approach: increased investment in public institutions which provide services directly, financed from national revenue. This is in fact the only way that countries – including developed countries – have succeeded in providing health services based on need rather than ability to pay.

Apparently, such ideological bias in World Bank research is not the exception. A recent independent audit of World Bank research, which examined over 4,000 World Bank activities between 1998 and 2005, found that rather than policy being formulated on the basis of a balanced analysis of a wide range of research, policies were often formulated on the basis of historical preference, and then backed up by selective research and biased analysis.[13]

The panel that carried out the evaluation, made up of distinguished academic figures, had substantial criticisms of the way that World Bank research was used to proselytize on behalf of World Bank policy, often without taking a balanced view of the evidence, to the point that "the degree of self-reference rises almost to the level of parody." These conclusions are also supported by recent research commissioned by the Norwegian government regarding World Bank and International Monetary Fund (IMF) economic policy conditionality: "The most serious weakness of the IFI [international financial institution] reports is their quite narrow methodological and disciplinary starting points."[14]

13 Banerjee, A. *et al* (2006). "An Evaluation of World Bank Research, 1998-2005".

14 Norwegian Ministry of Foreign Affairs (2006). "The World Bank's and the IMF's use of Conditionality to Encourage Privatization and Liberalization: Current Issues and Practices".

The assumptions behind the SRM approach are also at the core of the market-based solutions advanced by the Bank to extend access to social protection in the health sector. In particular, the Bank proposes systematizing existing levels of payments into formal, insurance-based systems. In low-income countries where the majority of the population lives on less than USD 2 a day, there is no evidence that this approach helps to build equitable health systems. On the contrary, there is evidence that publicly financed systems are better able to provide universal, equitable access to services in low-income situations.

By choosing this questionable solution, the Bank once again deliberately reduces the role of the state and public intervention on the basis of the ideological and unproven assumption that private health providers are more accountable, of higher quality and more efficient than public providers. Public sector workers are presented as corrupt, with no analysis of why corruption thus defined occurs among this group, and no comparative analysis of how and why massive corruption also occurs in private provider contracts. The Bank's strategy ignores the evidence of successful reforms to strengthen the training, recruitment and retention of more highly motivated and better-compensated public sector health care workers, and proposes only to bypass the public sector in favour of a falsely valorized private sector. In promoting private service provision, the strategy is practically promoting internal migration from the public to the private sector and therefore further fragmentation of public health systems.

Undue constraints on fiscal space for health and social policies

It should be noted that the new health strategy aims only to advise low-income countries on reforms within their fiscal and absorptive capacity constraints. The World Bank should, instead, aim to assist recipient countries to overcome those constraints, rather than viewing them as a given. In particular, the Bank should not push low-income countries to be "selective and realistic" about which results they can achieve in this field, but should, on the contrary, help these countries to deliver a comprehensive package of health services to the whole population. In this regard, the strategy fails to acknowledge the impact of IMF policies on countries' ability to adequately address their human resource crisis and provide universal access to quality health care for all.

In July 2007 the Centre for Global Development's working group examining the IMF and health spending – which was chaired by ex-IMF staffer David Goldsbrough and included officials, academics and representatives of civil society – found that the Fund has unduly constrained countries' policy choices. The group analysed in detail the specific cases of Mozambique, Rwanda and Zambia and concluded that "IMF-supported fiscal programs have often been too conservative or risk-averse. In many cases, they have unduly narrowed policy space by not investigating sufficiently more ambitious, but still potentially feasible, fiscal options for higher spending and aid."[15] The working group advanced a series of recommendations to international financial institutions, including the need to help countries explore a broader range of options for the fiscal deficit and public spending and to drop wage bill ceilings from nearly all social programmes.

An individual fight against poverty?

The element of the SRM framework aimed at refocusing social policy towards encouraging individual risk taking is potentially problematic in a more general sense. On the one hand, the failure of conventional approaches to public social policy to satisfactorily reduce poverty in developing countries and, on the other hand, their much debated contribution, predominantly through labour-market distortions, to the creation of a welfare-dependent underclass in developed economies, are often portrayed as being indicative of 'state failure'. Following this approach to the problem, it must be assumed, therefore, that the stress placed by SRM upon the need for an increasingly proactive and inherently risky role for the individual in a personalized fight against poverty will permit poverty to be increasingly defined, from a neoliberal perspective at least, as 'individual failure'.

Consequently, in some cases the SRM approach to social protection may actually contribute further to the social and economic exclusion of the poor, and those individuals who remain in poverty, for whatever reason, are likely to face a greater degree of stigmatization to the point of being seen as living in a "pathological condition."[16] Accordingly, with the possible exception of the truly indigent, the chronic poor may come to be regarded as not only undeserving but beyond help. Such an unacceptable view structurally undermines the belief that social protection is a fundamental right of all citizens.

Given that riskier activities, by definition, promise the potential of higher returns when successful and also the likelihood of severe, and potentially catastrophic, losses when they fail, in principle it may be deemed inappropriate for an international organization such as the World Bank to encourage individuals to engage in activities which hold the inherent potential for encountering such losses.[17] ■

15 Center for Global Development (2007). "Does the IMF Constrain Health Spending in Poor Countries? Evidence and an Agenda for Action". Report of the Working Group on IMF Programs and Health Spending.

16 Vilas, C. (1996). "Neoliberal social policy: managing poverty (somehow)". *NACLA Report on the Americas*, Vol. 29, No. 6.

17 See footnote 10.

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The right to social security: Can it be brought to court?

The right to social security has been successfully brought before international and regional courts and bodies that are empowered to receive applications or complaints and consider alleged violations of rights categorized a priori as civil or political. This became possible when the interconnection between the right to social security and other rights and principles was demonstrated. Although this type of indirect protection has proved to be significant, there are still aspects of social security that are poorly served by it or excluded from it. The development of direct justiciability mechanisms would rectify this situation.

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1. Introduction

The right to social security[2] has been included in the catalogue of human rights since the adoption of the Universal Declaration of Human Rights itself in 1948 (see Article 22).[3] It is also enshrined in a significant number of global and regional human rights treaties and in instruments adopted by the International Labour Organization (ILO).[4]

Nothing of what is said here is intended to deny the conceptual possibility of regarding the right to social security as an actionable right.[5] National experiences demonstrate that the right to social security, including rights derived from social security regimes, together with employment rights, are areas in which litigation precedence is firmly established at a local level, both in developed and developing countries. However, at an international level, the scope of direct justiciability on this right has been limited, due particularly to the persistence of various restrictions that limit justiciability on economic, social and cultural rights. Nevertheless, adjudication on the right to social security falls within the judicial or quasi-judicial brief of global and regional human rights courts and bodies that are empowered to receive applications, petitions and complaints.

This report will endeavour to present several different ways in which various aspects of the right to social security – through its interconnection with other rights – have been addressed by courts and bodies empowered to consider alleged violations of rights categorized *a priori* as civil or political.

Without pretension to being exhaustive we will consider below three principal means of indirect protection for aspects of the right to social security: a) aspects of social security as a component of interests protected under the right to property; b) procedural aspects relating to due process guarantees and effective judicial tutelage of the right to social security; and c) the prohibition of discrimination and the equality principle as applicable to the right to social security.

2. The protection of the right to social security through the right to property

One of the indirect forms of protection for the right to social security has been the inclusion of rights and expectations relating to social security benefits among the interests protected by the right to property. We will now examine how this protection functions in two regional human rights systems, the European and the Inter-American.

2.1. European human rights system

In the European system of human rights, this form of protection has manifested through the application of Article 1 of Protocol No. 1 to the European Convention for the Protection of Human Rights and Fundamental Freedoms. The central issue is the scope of the terms "property" or "possessions" in the article's text. A narrow consideration of these terms could limit the scope of the article, for example, to property understood only in the sense of physical property or property already incorporated in a person's total assets. But a wider interpretation of interests that can be included in the terms "property" or "possessions" would allow for a looser notion of "property" that, given the fulfilment of certain conditions, incorporates the expectation of receiving a pension, or other form of money transfer, and of its maintenance, updating or adjustment, among other possibilities.

The old European Commission of Human Rights and the current European Court of Human Rights have clearly leaned towards this second possibility and have considered in many cases that social security benefits

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2 References to "the right to social security" in this article include both contributory social security and non-contributory or welfare assistance; this differentiation is omitted as jurisprudence indicates its irrelevance in the light of protection offered by rights incorporated in civil and political rights instruments.

3 See for example, Andreassen, B.A. (1999). "Article 22", in Alfredsson, G. and Eide, A. (comps.), *The Universal Declaration of Human Rights: A Common Standard of Achievement*. The Hague: Martinus Nijhoff Publishers, p. 453-488.

4 See Courtis, C. (2003). "El derecho a la seguridad social en el derecho internacional", in Abramovich, V., Añón, M.J. and Courtis, C. (comps.), *Derechos sociales: instrucciones de uso*. Mexico: Fontamara, p. 257-270; Scheinin, M. (2001). "The right to social security", in Eide, A. Krause, C. and Rosas, A. (comps.), *Economic, Social and Cultural Rights. A textbook*. Dordrecht/Boston/London: Martinus Nijhoff Publishers, 2nd Ed., p. 213-220.

5 Our general position on this can be found in Abramovich, V. and Courtis, C. (2004). *Los derechos sociales como derechos exigibles*. Madrid: Trotta, 2nd Ed.

PETITION MECHANISMS IN INTERNATIONAL AND REGIONAL HUMAN RIGHTS BODIES

- At an international level, there is still no mechanism for applications and petitions that facilitates the presentation of complaints about violations of rights embodied in the International Covenant of Economic, Social and Cultural Rights (ICESCR). However, Article 24 of the ILO Constitution entitles unions and employers' organizations to present 'claims' in the case of inadequate compliance by the state with a convention that it is party to. This includes conventions relating to social security such as Conventions 102, 121, 128, 130, 168, 103 revised, 118 and 157, among others.
- In Europe the Additional Protocol to the European Social Charter, which establishes a system of collective complaints, allows legitimate stakeholders to present complaints alleging an unsatisfactory implementation of obligations arising from the European Social Charter of 1961, or its revised version of 1996, by a state that is party to it.
- The Inter-American human rights system allows for the presentation of individual petitions to the Inter-American Commission on Human Rights alleging violations of the right to social security as established by Article 16 of the American Declaration of the Rights and Duties of Man. Additionally, arguments have been made supporting the possibility of taking questions relating to direct violations of the right to social security to the Inter-American Court of Human Rights, but the practical application of this has thus far been disappointing.

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– including both contributory and non-contributory benefits – constitute "property" or "possessions", as referred to in Article 1 quoted above, and that they therefore deserve protection against state actions that prejudice their peaceful enjoyment.

So, for example, even in 1971 the now inexistent European Commission of Human Rights held that "while it is clear that no right to a pension is as such included in the Convention (European Convention on Human Rights), the making of compulsory contributions to a pension fund may, in certain circumstances, create a property right in a portion of such fund and that such right may be affected by the manner in which the fund is distributed."[6] The European Court of Human Rights has upheld this interpretation in many cases. The Court has also held that rights deriving from the payment of contributions to social security systems are pecuniary rights as defined in Article 1 of Protocol No. 1 to the European Convention.[7] For example in the case of *Willis v. United Kingdom*, the European Court considered that the right to receive a widow's payment and a widowed mother's allowance from a contributory regime constituted a pecuniary right as defined in Article 1 of Protocol No. 1 to the European Convention.[8] The Court has repeated this criterion in many other cases.[9]

Once the protection of social security benefit rights through the right to property is established, it is necessary to examine the criteria used by European human rights system bodies to determine the existence of a violation of such right in relation to pensions and other social security benefits.

It should be remembered that in regard to economic and social policy, the European Court has developed the notion of "margin of appreciation", which implies a certain deference in court deliberations towards state decisions on questions of public policy, both in regard to its ends and the means chosen to achieve them. In social security, with its need for complex system management, this notion has been reflected in the opinion of the Commission, subsequently adopted by the European Court, that the acknowledgement of the possible extension of property right protection to social security benefits does not imply the guaranteeing of the right to a particular amount. Neither does it signify the right to the establishment of specific types of benefit, given that the state has a wide discretional margin to create and design social security schemes and their mode of finance. And even in the case of public policy objectives that need to be prioritized, the state has a certain margin to choose the means and timetable for their accomplishment. Finally, in order to establish the existence of a pecuniary right, the Court requires that the person alleging a violation meets the conditions prescribed by the relevant national law for obtaining the claimed benefit.

Having said that, however, it is necessary to emphasize that the state's margin of appreciation is not unlimited, and that, in several cases, the European Court determined that measures adopted by the state in question constituted an unjustified interference in the applicant's enjoyment of the right to property. We will therefore examine which criteria have been employed by European system bodies to determine an infringement of the duty of respect for the right to property in relation to social security.

Reductions that affect the substance of a right

In its final report on the *Müller v. Austria* case,[10] the European Commission held that "a substantial reduction of the amount of the pension could be regarded as affecting the very substance of the right to retain the benefit of the old age insurance." It could then be asked what degree of reduction would affect the very substance of the right. Although European jurisprudence does not provide mathematical formulas, it does at least provide some useful guidelines to categorize the degree of effect. In this case, the European Commission decided that a reduction of approximately 3% in the pension – the difference claimed by the applicant in this case – did not affect the substance of the right. At the opposite extreme, in the case of *Kjartan Asmundsson v. Iceland*, the European Court held that the cessation of a social security disability benefit resulting from a work-related injury represents an unjustified interference in the right to property of the victim.[11] And in the case of *Wessels-Bergervoet v. The Netherlands*, which is not directly related to a reduction in the amount of a social security benefit, the Court provides a guideline that, by analogy, can be significant in determining the effect on the substance of the right. In this case, the Court considered that a difference of 38% between the pension received by the woman applicant and the one she would have received in the same conditions had she been a man, constituted an unjustified and discriminatory difference in treatment.[12] It could be argued that this percentage represents at least a guideline for what constitutes an intolerable difference in the area of social security.

Discrimination and violations of the equality principle

In a series of cases, the European Court has considered allegations of discrimination or violations of the equality principle in relation to protection derived from the right to property as applied to social security rights. These cases will be examined in section 4, which is exclusively devoted to the issues of discrimination and violation of the equality principle in relation to this matter.

Res judicata violation and non-compliance with judgments

Another criterion used to determine an unjustified effect on the right to property is the lack of respect by a state for final judgments that fix the amount of the benefits. So, for example, in the case of *Pravednaya v. Russia*, the European Court determined that the retroactive application of a regulation and the reopening of a case in order to modify a final judgment constituted unjustified interference with the applicant's right to property.[13] In another series of cases relating to compensation for work-related sickness and accident,[14] pension readjustment[15] and maternity benefits,[16] the Court held that the state's non-compliance with judgments that required it to pay such benefits also constituted violations of the right to property.

In summary, in all these cases the Court considered that the validity and amount of a social security benefit determined in a final judgment formed part of the beneficiary's assets.

2.2. Inter-American human rights system

Although the experience of the inter-American system of human rights in this area is less, there are precedents for such cases. In this system, protection of the right to property is based on Article 21 of the American Convention on Human Rights.

6 See European Commission of Human Rights, case *X v. The Netherlands*, Application No. 4130/69, Decision of 20 July 1971, Collection 38, p. 9. On the same subject, case *Mrs. X v. The Netherlands*, Application No. 5763/72, Decision on admissibility of 18 December 1973, Collection 45 p. 76.

7 See European Court of Human Rights, case *Gaygusuz v. Austria*, Application No. 17371/90, Judgment of 16 September 1996, paras. 39-41. See also case *Skorkiewicz v. Poland,* Application No. 39860/98, Decision on admissibility of 1 June 1999, para. 1; case *Domalewski v. Poland*, Application No. 34610/97, Decision on admissibility of 15 June 1999, para. 2.

8 See European Court of Human Rights, case *Willis v. United Kingdom*, Application No. 36042/97, Judgment of 11 June 2002, paras. 32-36.

9 See for example European Court of Human Rights, cases *Aunola v. Finland*, Application No. 30517/96, Decision on admissibility of 15 March 2001, para. 2; *Buchen v. Czech Republic*, Application No. 36541/97, Judgment of 26 November 2002, para. 46; *Van den Bouwhuijsen and Schuring v. The Netherlands,* Application No. 44658/98, Decision on admissibility of 16 December 2003; *Kjartan Asmundsson v. Iceland*, Application No. 60669/00, Judgment of 12 October 2004, para. 39; *Pravednaya v. Russia*, Application No. 69529/01, Judgment of 18 November 2004, para. 38; *Macovei and others v. Moldova*, Application No. 19253/03, 17667/03, 31960/03, 19263/03, 17695/03 and 31761/03, Judgment of 25 April 2006, para. 49; *Pearson v. United Kingdom*, Application No. 8374/03, Judgment of 22 August 2006, para. 21.

10 See European Commission of Human Rights, case *Müller v. Austria*, Application No. 5849/72, Final Report of 1 October 1975, DR 1, para. 32

11 See European Court of Human Rights, case *Kjartan Asmundsson v. Iceland*, Application No. 60669/00, Judgment of 12 October 2004, para. 45. See also case *Azinas v. Cyprus*, Application No. 56679/00, Judgment of 20 June 2002, paras. 44 and 45, in which the Court held that complete denial of a contributory pension as a form of punishment for committing a crime is a disproportionate measure that violates Article 1 of Protocol No. 1 to the European Convention.

12 See European Court of Human Rights, case *Wessels-Bergervoet v. The Netherlands*, Application No. 34462/97, Judgment of 4 June 2002, para. 52.

13 See European Court of Human Rights, case *Pravednaya v. Russia*, Application No. 69529/01, Judgment of 18 November 2004, paras. 39-41.

14 See European Court of Human Rights, case *Burdov v. Russia*, Application No. 59498/00, Judgment of 7 May 2002, paras. 40-41.

15 See European Court of Human Rights, case *Makarova and others v. Russia*, Application No. 7023/03, Judgment of 24 February 2005, paras. 31-33; case *Plotnikovy v. Russia*, Application No. 43883/02, Judgement of 24 February 2005, paras. 27-29.

16 See European Court of Human Rights, case *Poznakhirina v. Russia*, Application No. 25964/02, Judgment of 24 February 2005, paras. 27-29.

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In an early case the Inter-American Commission on Human Rights erred but fortunately this was corrected in later proceedings. In its Final Report on the *Marzioni* case, the Inter-American Commission adopted a very narrow notion of property, rejecting the possible inclusion in such a concept of work-related injury compensation[17] – which, incidentally, is included among the social security "branches" stipulated in ILO Convention No. 102.[18]

However, the Commission reviewed its position on this in the case of *Five Pensioners v. Peru*, which was finally submitted for consideration by the Inter-American Court of Human Rights. The case involved the modification of pension amounts established by law, and the non-compliance by the Peruvian state with court judgments that held the reduction of the petitioners' pensions to be illicit and determined the amount to be paid. The Inter-American Court considered that, once the conditions established by law were fulfilled, the pension constituted an acquired right of the victims and in consequence had been incorporated in their total assets and was thus subject to protection through the right to property.[19] Consequently, the Court determined that the arbitrary modification of the pensions' amount (as high as 78%) constituted a violation of the right to property.[20] The Court, in a similar conclusion to that of European Court jurisprudence, also determined that the refusal of the state to fully pay pensions, the amount of which was determined by final judgment, constituted a violation of the right to property enshrined in Article 21 of the American Convention.[21]

FAIR TRIAL GUARANTEES ENSHRINED IN REGIONAL HUMAN RIGHTS INSTRUMENTS

- **European Convention on Human Rights and Fundamental Freedoms**
  Article 6: Right to a fair trial
  1. In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgment shall be pronounced publicly but the press and public may be excluded from all or part of the trial in the interests of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or to the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice.

- **American Convention on Human Rights**
  Article 25: Judicial protection
  1. Everyone has the right to simple and prompt recourse, or any other effective recourse, to a competent court or tribunal for protection against acts that violate his fundamental rights recognized by the constitution or laws of the state or by this Convention, even though such violation may have been committed by persons acting in the course of their official duties.
  2. The States Parties undertake: a) to ensure that any person claiming such remedy shall have his rights determined by the competent authority provided for by the legal system of the state; b) to develop the possibilities of judicial remedy, and c) to ensure that the competent authorities shall enforce such remedies when granted.

  Article 8: Right to a fair trial
  The text of Article 8.1 of the American Convention on Human Rights avoids the discussions that arose in the European Court of Human Rights about the "civil nature" of a dispute, as it explicitly acknowledges its application to the "determination of […]rights and obligations of a civil, labor, fiscal, or any other nature."

In relation to this, and looking only at social rights issues, the Court has applied Article 8.1 to employment-related cases (*Baena and others v. Panama*, *Acevedo Jaramillo v. Peru* and *Dismissed Congressional Employees v. Peru*), and to proceedings for independent legal status acknowledgement and the award of collectively owned land titles for indigenous communities (in the cases *Awas Tingni v. Nicaragua*, *Yakye Axa v. Paraguay* and *Sawhoyamaxa v. Paraguay*).

3. Protection of the right to social security through the right to fair trial guarantees and effective judicial recourse

Both the European Court of Human Rights and the Inter-American Court of Human Rights have considered cases of social security benefits being affected by violations of due process and the obligation to provide effective judicial tutelage in the event of violations of fundamental rights.

3.1. European human rights system

The European Court has an extensive jurisprudence covering the application of Article 6.1 of the European Convention on Human Rights, with a series of cases referring to rights related to social security, including welfare assistance. Part of the initial discussion on this subject related to the need to interpret the scope of the text of Article 6.1 on the "determination of his *civil* rights and obligations."

In the case of *Feldbrugge*, the Court discussed the applicability of Article 6.1 to a payment continuity dispute in regard to an unemployment sickness allowance derived from public health insurance. The Court, taking into account a series of factors – among them the economic and personal nature of the right, its link with the work contract and its affinity with private insurance schemes – determined that, under Article 6.1, it could be considered a civil dispute.[22] In the case of *Deumeland*, the applicant was claiming the payment of a supplementary widow's pension, as her husband had died in a work accident. Based on the criteria employed in the previous case, the Court concluded that the dispute could be considered civil and thus Article 6.1 was applicable to the case.[23]

In the case of *Salesi*, the Court had to consider the applicability of Article 6.1 to determination of legitimacy proceedings for a monthly disability benefit. Unlike the *Feldbrugge* and *Deumeland* cases, in which the type of benefit was directly or indirectly linked to an employment relationship and to a contributory scheme, here the benefit was entirely financed by public funds and therefore the case did not strictly speaking fall within the sphere of "social security" but rather in the sphere of "welfare assistance".[24] The Court held that:

> Certainly there are differences between the two [welfare assistance and social security], but they cannot be regarded as fundamental at the present stage of development of social security law. This justifies following, in relation to the entitlement to welfare allowances, the opinion which emerges from the aforementioned judgments as regards the classification of the right to social insurance benefits, namely that State intervention is not sufficient to establish that Article 6 para. 1 is inapplicable.
> As in the two cases previously referred to, other considerations argue in favour of the applicability of Article 6 para. 1 in the instant case. The most important of these lies in the fact that despite the public law features pointed out by the

17 See Inter-American Commission of Human Rights, case *Marzioni v. Argentina*, case 11673, Report 39/96, 11 October 1996, particularly para. 29.

18 See ILO Convention 102, part 6, articles 31-38.

19 See Inter-American Court of Human Rights, case *Five Pensioners v. Peru*, Judgment of 28 February 2003, paras. 102 and 103.

20 *Ibid*, paras. 109, 111, 112, 116-118 and 121.

21 *Ibid*, paras. 113-115, 117, 118 and 121.

22 See European Court of Human Rights, case *Feldbrugge v. The Netherlands*, Application No. 8562/79, Judgment of 29 May 1986, paras. 26-40, particularly paras. 36-40.

23 See European Court of Human Rights, case *Deumeland v. Germany*, Application No. 9384/81, Judgement of 29 May 1986, paras. 60-74, particularly paras. 71-74.

24 See European Court of Human Rights, case *Salesi v. Italy*, Application No. 13023/87, Judgement of 26 February 1993, paras. 17-19.

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> Government, Mrs Salesi was not affected in her relations with the administrative authorities as such, acting in the exercise of discretionary powers; she suffered an interference with her means of subsistence and was claiming an individual, economic right flowing from specific rules laid down in a statute giving effect to the Constitution.[25]

The Court therefore determined that there were no reasons for a conclusion different to those in the cases of *Feldbrugge* and *Deumeland*, and considered that Article 6.1 was applicable to the circumstances under examination.

Given these and other precedents, in subsequent cases disputes over the applicability of Article 6.1 to social security issues became practically inexistent. The Court applied Article 6.1 to proceedings for work-related injury and sickness compensation,[26] pension readjustment,[27] maternity benefits[28] and income for life from a retirement fund.[29]

Having dealt with the question of the applicability of Article 6.1 to proceedings relating to social security benefits and contributions, we will now examine which components of the right to a fair trial and to due process guarantees were applied by the European Court to cases of interest here, without prejudice to the applicability of other component elements of such guarantees developed in the Court's jurisprudence.[30]

Equality of arms[31] and the public and oral nature of proceedings

Some of the cases referred to involved disputes about respect for the principle of equality of arms that is inherent to the notion of due process, particularly during the administrative process that commonly takes place in many social security systems before recourse to judicial proceedings.

In the previously cited *Feldbrugge* case, the Court held that the process that determined the discontinuation of an unemployment sickness allowance failed to guarantee the petitioner's rights to be heard, to present written arguments or to consult and object to evidence in the case file.[32] The Court also considered that the process seriously limited the applicant's right to question the decision of the medical board that decided her case.[33] In consequence the Court ruled that the state had violated Article 6.1 of the European Convention.

Reasonable timescale

One of the components of the notion of a fair trial and due process invoked in the context of proceedings relating to social security is the right of the applicant to obtain a ruling that ends the dispute in a reasonable time. This principle is particularly important in the area of social security, given the life-sustaining nature of its benefits.

In the case of *Deumeland*, for example, the Court ruled that the duration of the determination process for the claimed benefit (ten years, seven months and three weeks) violated the principle of reasonable timescale enshrined in Article 6.1 of the European Convention.[34] The Court emphasized that social security cases require "particular diligence."[35]

Respect for *res judicata* and judgment compliance

The Court has also applied the requirement of respect for *res judicata,* as an obligation of the state, to cases relating to social security benefits, and has held in a significant number of cases that the state violated Article 6.1 through non-compliance with judgments obliging it to pay benefits of an amount judicially determined, or through an absence of respect for final judgments as in the establishment of means to reopen and examine cases that had already been decided.

In several cases the European Court has expressly emphasized that a state's claim to having insufficient resources does not constitute a valid excuse for non-payment of a judicially established debt.[36]

3.2. Inter-American human rights system

The Inter-American Court has in turn applied American Convention on Human Rights Article 25 (the right to judicial protection) in proceedings on a claim for pension readjustment by the petitioners in the case of *Five Pensioners v. Peru.*[37] Although the representatives of the victims invoked Article 8.1 of the American Convention (equivalent to Article 6.1 of the European Convention), the Court refused to consider this due to insufficient evidence in the case file. In this case, the Court considered the state's non-compliance with a judgment that obliged it to pay pensions in accordance with the petitioners' claim. Similarly to its European equivalent, but on the basis of a different juridical categorization, the Inter-American Court determined that the Peruvian state's non-compliance, over a period of eight years, with judgments requiring it to pay pensions in accordance with the petitioners' claim constituted a violation of the right to effective judicial tutelage.[38]

4. Protection of the right to social security through the principle of equality and the prohibition of discrimination

A third way of protecting the right to social security through human rights instruments that allow the presentation of applications or petitions, is its articulation with arguments based on the violation of the principle of equality and the prohibition of discrimination. The strategy in such cases is to denounce the existence of unjustified or discriminatory distinctions relating to social security, for example in terms of the conditions of access to certain benefits or the amount of the benefits. This strategy has also been accepted in national courts of different jurisdictions around the world.[39]

In some international human rights instruments – such as the International Covenant on Civil and Political Rights (ICCPR)[40] and the American Convention on Human Rights[41] – the clauses enshrining the right to equal protection from the law and the prohibition of discrimination are general and therefore are also applicable to rights and regulations that are not included in the list of rights established in the instruments themselves. Consequently, these provisions can be directly invoked where social security legislation, or the practice of entities in charge of applying it, violates the principle of equality and the prohibition of discrimination.

Other instruments, such as the European Convention on Human Rights, limit the application of the provision that enshrines the principle of equality and the prohibition of discrimination to rights established in the instrument itself.[42] Here, therefore, in bringing actions relating to social security it is necessary to relate the clause with the alleged violation of a

25 *Ibid*, para. 19.

26 See European Court of Human Rights, case *Burdov v. Russia,* Application No. 59498/00, Judgement of 7 May 2002, paras. 34-38.

27 See European Court of Human Rights, case Pravednaya v. Russia, Application No. 69529/01, Judgment of 18 November 2004, paras. 24-34; case Makarova and others v. Russia, Application No. 7023/03, Judgment of 24 February 2005, paras. 26-30; case Plotnikovy v. Russia, Application No. 43883/02, 24 February 2005, paras. 22-26.

28 See European Court of Human Rights, case *Poznakhirina v. Russia*, Application No. 25964/02, Judgment of 24 February 2005, paras. 22-26

29 See European Court of Human Rights, case *Macovei and others v. Moldova*, Applications No. 19253/03, 17667/03, 31960/03, 19263/03, 17695/03 and 31761/03, Judgment of 25 April 2006, paras. 39-46.

30 See Abramovich and Courtis, *op. cit.*, p. 184-192.

31 The equality of arms principle requires that all parties to a process receive the same treatment from judicial bodies.

32 See European Court of Human Rights, case *Feldbrugge v. The Netherlands*, Application No. 8562/79, Judgment of 29 May 1986, para. 44.

33 *Ibid*, para. 45-46.

34 See European Court of Human Rights, case *Deumeland v. Germany*, Application No. 9384/81, Judgement of 29 May 1986, paras. 76-90.

35 *Ibid*, para. 90.

36 See European Court of Human Rights, case *Burdov v. Russia*, Application No. 59498/00, Judgement of 7 May 2002, para. 35; case *Makarova and others v. Russia*, Application No. 7023/03, Judgement of 24 February 2005, para. 27; case *Poznakhirina v. Russia*, Application No. 25964/02, Judgement of 24 February 2005, para. 23; case *Plotnikovy v. Russia*, Application No. 43883/02, 24 February 2005, para. 23.

37 See Inter-American Court of Human Rights, case *Five Pensioners v. Peru*, Judgment of 28 February 2003, paras. 127-141.

38 *Ibid*, particularly paras. 133-138 and 141.

39 See for example, Constitutional Court of South Africa, case *Khosa and others v. Minister of Social Development and others*, 2004 (6) SA 505 (CC), 4 March 2004 (discrimination in access to social security benefits due to national origin); Spanish Constitutional Tribunal, Judgments 103/83, of 22 November 1983 (discrimination against men in relation to women in widower/widow pensions) and 116/87 of 9 July 1987 (unjustified distinctions between categories of workers for social security purposes); Italian Constitutional Court, Judgment No. 184 of 1983 (unjustified distinctions between beneficiaries of disability pensions and old age pensions in regard to health expenditure exemptions).

40 See International Covenant on Civil and Political Rights, art. 26.

41 See American Convention on Human Rights, art. 24.

42 See European Convention on Human Rights and Fundamental Freedoms, Art. 14. It has to be specified that Protocol No. 12 to the European Convention on Human Rights extends the application of the prohibition of discrimination to all rights established by law (see Art. 1, Protocol No. 12 to the European Convention of Human Rights). However, by August 2007 there had been only 15 ratifications of this Protocol.

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right protected by the European Convention or by its additional Protocols.

We will now examine how the principle of equality and the prohibition of discrimination are dealt with in different human rights protection systems in relation to social security.

4.1. Universal system of human rights

Within the framework of the universal system for the protection of human rights, the Human Rights Committee – a body that monitors compliance with the ICCPR – has had several opportunities to consider alleged violations of the principle of equality and the prohibition of discrimination.

In two already classic cases in its jurisprudence, *Zwaan de Vries v. The Netherlands*[43] and *Broeks v. The Netherlands*,[44] the Committee determined that Dutch unemployment compensation legislation discriminated against married women by imposing access conditions on them that were not required in the case of married men in the same situation. The Committee held that this different treatment on the basis of gender constituted a violation of ICCPR Article 26.

In a recent case the Committee reached a similar conclusion, this time with regard to distinctions established by Colombian legislation in relation to pension transfer. The Committee considered that the distinction made on the basis of the sexual orientation of the petitioner – the partner of the dead beneficiary – was discriminatory, because the law provided protection to common law partners of different gender but not to partners of the same gender.[45]

4.2. European human rights system

The European Court of Human Rights has considered a series of cases involving alleged discrimination, or violation of the principle of equality, in terms of the protection derived from the right to property as applied to social security rights. The Court held that the protection of the right to property established in Article 1 of Additional Protocol No. 1 to the European Convention on Human Rights does not imply a right to acquire property, nor does it prescribe any restriction on the state's freedom to establish any type of social security scheme or to set the type and amount of the benefits in such a scheme. However, if the state creates a benefits or pensions system, it should do so in a way that is compatible with Article 14 of the European Convention, that is, in a way that respects the principle of equality and the prohibition of discrimination.[46]

In the case of *Stec and others v. United Kingdom*, the applicants alleged that the establishment of the retirement age as the limit for the payment of a work-related accident compensation allowance was discriminatory, as in the United Kingdom there is a different retirement age for men and women (65 for men and 60 for women).[47] The Court considered two questions separately. First, it concluded that linking the payment of the work accident compensation allowance with the normal employment period, and establishing its limit as the retirement age, had a legitimate purpose and was therefore reasonable. It then considered the gender-related difference in retirement age. On this point the Court found that a different retirement age for men and women was originally justified as a measure aimed at correcting existing inequalities between men and women and therefore could be considered reasonable, but that the difference in treatment should cease when social and economic changes remove the need for special treatment for women.

However, the Court indicated that as this social change has been gradual it is not possible to determine an exact moment in time when the differential measure becomes disproportionate. The Court also pointed out that, after a national consultation process, the state has adopted measures to correct this differentiated treatment by establishing a gradual gap reduction scheme in stages. The Court concluded that, given the original justification of the differentiated treatment and the gradual change in the social and economic position of women, the measures and timescale chosen by the state to equalize retirement ages were not so manifestly unreasonable as to exceed the wide margin of appreciation that it has in these matters. In consequence it considered that there was no violation of Article 14 of the Convention, in relation to Article 1 of Protocol 1.

In two other cases, involving access to social security benefits, the European Court considered legal distinctions based on the national origin of the victims (which, it should be remembered, is one of the bases for discrimination that is prohibited by Article 14 of the European Convention on Human Rights).

In the case of *Gaygusuz v. Austria*, the Court had the opportunity to consider the compatibility of the prohibition of discrimination with the Austrian regulation for the granting of emergency social benefits in cases of unemployment benefit cessation.[48] The applicant had met all of the benefit access conditions – among them having contributed to the unemployment insurance fund – except the one of having Austrian nationality. The Court rejected the government's arguments and ruled that the distinction based on nationality lacked objective and reasonable justification and was therefore discriminatory. In the case of *Koua Poirrez v. France*, the applicant – a disabled person originally from Côte d'Ivoire – contested the denial of a disability benefit on the grounds of nationality. Again the Court decided that the distinction on the basis of nationality lacked objective and reasonable justification and was therefore discriminatory, violating Article 14 of the European Convention in relation to Article 1 of Protocol No. 1.[49]

5. Final considerations

This outline jurisprudence survey has demonstrated that an appreciable proportion of right to social security aspects have been taken up by international courts and human rights bodies through their interconnection with other rights and principles.

It is relevant here to evaluate the degree of coverage offered by these indirect forms of protection in order to determine what would be added by direct justiciability for the right to social security at an international level.[50]

The forms of indirect protection of the right to social security presented in this paper include both substantive and procedural aspects.

On the substantive side, protection through the right to property has proved useful in protecting access to social security benefits already established by law, ensuring their payment and maintaining their integrity. This type of protection functions particularly well in states with a broad-based social security regime that is sufficiently disciplined from a regulatory point of view. Here, even in the case of non-contributory benefits, the degree of tutelage will be greater the more that conditions of access to the benefit are clearly established by law and, conversely, it will be lesser to the extent that access is left to the discretion of the authorities – a state of affairs that regrettably continues to be the norm in regard to social assistance in many countries, including those of Latin America.

The protection of the integrity of benefits is not absolute but relative and leaves the state with a margin of appreciation to implement modifications provided that they have legitimate ends and the measures adopted are proportionate to them. However, this tutelage establishes some limits to the margin of appreciation, basically in the form of requiring respect for the substance of the right – in other words, the reasonability of the restriction or limitation – and respect for court judgments that end a dispute.

The substantive aspect of protection is complemented by the principle of equality and the prohibition of discrimination. The use of these principles allows some degree of control over regulations that establish benefits, particularly in those cases where the state has made distinctions based on the so-called 'suspicious categories', such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or

43 See Human Rights Committee, case *Zwaan de Vries v. The Netherlands*, Application No. 182/1984, view adopted on 9 April 1987.

44 See Human Rights Committee, case *Broeks v. The Netherlands*, Application No. 172/1984, view adopted on 9 April 1987.

45 See Human Rights Committee, case *X v.Colombia*, Application No. 1361/2005, view adopted on 14 May 2007.

46 See European Court of Human Rights, case *Stec and others v. United Kingdom*, Applications No. 65731/01 and 65900/01, decision on admissibility of 6 July 2005, paras. 54 and 55 and Judgment of 12 April 2006, para. 53.

47 See European Court of Human Rights, case *Stec and others v. United Kingdom*, Judgment of 12 April 2006, Applications No. 65731/01 and 65900/01, paras. 54-56.

48 See European Court of Human Rights, case *Gaygusuz v. Austria*, Application No. 17371/90, Judgment of 16 September 1996, paras. 33-51.

49 See European Court of Human Rights, case *Koua Poirrez v. France*, Application No. 40892/98, Judgment of 30 September 2003, paras. 46-49.

50 In addition to the mechanisms mentioned in section 2, negotiations are currently taking place in UN bodies for the adoption of a Facultative Protocol to the ICESCR. The ICESCR includes the right to social security in its Article 9. For more details on this process, the following websites can be consulted: <www.ohchr.org/english/issues/escr/intro.htm> and <www.opicescr-coalition.org>.

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other status, to quote those expressly established in Article 2.1 of the ICCPR, in Article 3 of the ICESCR and in Article 1.1 of the American Convention on Human Rights, although it should be mentioned that this list is not exhaustive.[51]

Protection through the principle of equality and the prohibition of discrimination can have an 'additive effect', that is, to extend an existent benefit to a category of beneficiaries who were excluded from it. But it should be emphasized that for this type of protection to be set in motion, it is necessary that the benefit already exists to some degree. Although a more vigorous interpretation of the prohibition of discrimination could be imagined – one that demands, for example, the creation of benefits as a necessary affirmative measure to prevent or eliminate discrimination – the abovementioned jurisprudence has still not moved in that direction.

The procedural aspects of protection – which encompass different aspects of due process guarantees and the right to effective judicial tutelage, as we have seen – also involve as a prerequisite the existence of legally established benefits, or procedures oriented to their creation, that constitute the object of the dispute.

By contrast, some aspects of the right to social security can be identified that are poorly covered by, or excluded from, these types of indirect protection and that would benefit from the establishment and implementation of direct justiciability mechanisms for this right.

In brief it could be said that direct justiciability of the right to social security at an international level could provide some supplementary substantive criteria for considering actions, and particularly omissions, on the part of a state in the establishment of social security benefits. To this end, *a clear determination of the eventualities that should be covered* would provide an important parameter for the detection of non-compliance and deficiencies.

A second aspect that could be considered is the *establishment of parameters for the appropriateness or sufficiency of benefits,* a notion that is partly reflected in the concepts of "minimum content", "core content", "vital or existential minimum" and "core obligations."[52] The challenge of this notion is to link relevant action taken by the state in this matter with measurable parameters in relation, as a minimum, to the cost of living or the meeting of basic or life-sustaining needs.

A direct justiciability of the right to social security could add a third aspect aimed at reinforcing the protection provided by the right to property, specifically in the social area, in the form of the so-called *prohibition against regressiveness* or prohibition of regression in terms of social rights.[53] In accordance with this principle, derived from the obligation to deliver a progressive development of social rights,[54] a state cannot diminish the content of those rights that it has already acknowledged. Although the prohibition is not absolute, it inverts the burden of justification, placing it on the state, and augments the required standard of justification for deliberately regressive measures. The prohibition against regressiveness could, for example, narrow the margin that the state has for justifying restrictions on the right to property in the case of restrictions or limitations to already existent social rights.

Having said this, and with the aim of not generating unfounded expectations, it is also necessary to remember that substantive state obligations in regard to social security are mitigated by the notion of "margin of appreciation" applicable to the state in the field of economic and social policies. Consequently, the more serious and visible the violation, the greater the impact will be of the suggested supplementary protection, particularly in the case of protection at an international level. ■

51 The enumeration in Art. 14 of the European Convention of Human Rights is similar: "…or any ground such as sex, race, colour, language, religion, political or other opinion, national or social origin, association with national minority, property, birth," in addition to the residual formula "or other status."

52 On this notion see, in general: Eide, A. (1989). "Realization of Economic, Social and Cultural Rights. Minimum Threshold Approach", in the International Commission of Jurists Journal, No. 43, p. 46-60; Chapman, A. and Russell, S. (2002). "Introduction", in Chapman, A. and Russell, S. (eds.), *Core Obligations: Building a Framework for Economic, Social and Cultural Rights.* Amaberes: Intersentia, p. 1-19. In particular on its application to the right to social security, see Lamarche, L. (2002). "The Right to Social Security in the International Covenant on Economic, Social and Cultural Rights", in Chapman and Russell (eds.), *ibid*, p. 87-114.

53 For more details on the prohibition against regressiveness, see works compiled in Courtis, C. (2006). *Ni un paso atrás. La prohibición de regresividad en material de derechos sociales.* Buenos Aires: Ed. del Puerto/CEDAL-CELS.

54 Enshrined in Art.2.1 of ICESCR, in Art. 26 of the American Convention on Human Rights and in Art. 1 of the San Salvador Protocol, among other instruments.

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Sexual and reproductive health: A right of women and men

Every minute one woman dies of pregnancy-related causes, while 125 to 200 million people would like to be able to control their fertility, but are not using contraceptives. If contraceptives were sufficiently available, 1.5 million lives would be saved per year. Although in 1994 the heads of state adopted the International Conference on Population and Development Programme of Action, funding for sexual and reproductive health and rights still lags behind at both the national and international level. Different policies have been adopted around the world but many governments still need to be convinced of the important economic impact that a good sexual and reproductive health care system can have.

Joyce Haarbrink
Marie Stopes International

The conception of social security is not limited to pensions, but also encompasses education, health, employment, and other spheres of life. There is serious concern over the dramatic situation created by the HIV/AIDS pandemic in Africa. Sexual and reproductive health and rights form part of the conception of social security from a rights-based perspective.

In accordance with the Global Policy Committee of the World Health Organization (WHO), reproductive health "implies that people are able to have a responsible, satisfying and safe sex life and that they have the capability to reproduce and the freedom to decide if, when and how often to do so. Implicit in this is the right of men and women to be informed of and to have access to safe, effective, affordable and acceptable methods of fertility regulation of their choice, and the right of access to appropriate health care services that will enable women to go safely through pregnancy and childbirth and provide couples with the best chance of having a healthy infant."[1]

Each man and woman is entitled to a whole range of fundamental human rights including the rights to life and health, the right to equality and non-discrimination, the right to be free from torture and cruel, degrading treatment, the right to dignity and the right to information. However, women in many parts of the world are not granted these rights. They are maltreated, raped, stigmatized, left to their own devices and politically ignored. Their sexual and reproductive health rights are often not recognized, let alone acted upon at the governmental, regional or community level. Yet, if women have the freedom to decide the number and spacing of their children and have access to the means of living a healthy and satisfying sex life, a country's economy and social structure will only benefit.

From population control to the right to sexual and reproductive health

In the 1980s and early 1990s sexual and reproductive health were closely related to the impact of population growth. This changed in 1994 when 179 heads of state and government came together in Cairo for the International Conference on Population and Development (ICPD) and adopted the ICPD Programme of Action (PoA). The signatories agreed that governments should "meet the family planning needs of their populations as soon as possible and should, in all cases by the year 2015, seek to provide universal access to a full range of safe and reliable family planning methods…"[2] They also acknowledged that men and women have the right to be informed and to have access to safe, effective, affordable and acceptable comprehensive methods of family planning of their choice, as long as they are not against the law.[3]

This decision was a watershed for population issues, as the policy evolved from 'population control' to recognizing the *right* of men and women to a healthy and satisfying sex life.[4]

In 1999 the 21st special session of the UN General Assembly revisited the ICPD PoA and adopted the Key Actions for the Further Implementation of the Programme of Action of the International Conference on Population and Development, stressing the linkages between sexual and reproductive health and rights and economic growth, the environment, education, equity and equality. Governments were invited to urgently accelerate the implementation of the ICPD PoA and mobilize the agreed estimated financial resources for its implementation.

In 2007, 13 years after the 1994 ICPD PoA granted women the right to be informed on sexual and reproductive health and rights (SRHR) and to have access to safe, effective, affordable and acceptable comprehensive methods of family planning of their choice, women in many parts of the world can still not exercise these rights and suffer from the consequences:

- Every minute one woman dies of pregnancy-related causes; this means 529,000 deaths every year, of which 68,000 are the result of unsafe abortions.
- 300 million women in the developing world currently suffer from short- or long-term illness brought about by pregnancies and childbirth.[5]
- 125 to 200 million people would like to be able to control their fertility, but are not using contraceptives[6] ('unmet needs'). If contraceptives were sufficiently available, 1.5 million lives would be saved per year.[7]
- More than half of women in the developing world aged 15 to 49 – around 705 million women in all – are at risk of unintended pregnancy.
- One third of women give birth by the age of 20; their babies are 1.5 times more likely to die within the first year of life compared to babies born to older mothers.
- Each year an estimated 2.2 million pregnant women infected with HIV/AIDS give birth. Around 700,000 neonates contract HIV/AIDS from their mothers either during pregnancy, labour, delivery or breastfeeding.[8]

In addition, one of the reasons for this situation is that there is hardly any funding available to support SRHR. In 1999 the ICPD PoA calculated that the implementation of the PoA would cost USD 17.0 billion in 2000, USD 18.5 billion in 2005 and USD 21.7 billion in 2015. Donors were invited to contribute one third of this amount, while the developing countries would allocate the remaining two thirds from domestic sources.[9] However, the funding targets indicated by the PoA have so far not been reached and funding for SRHR has actually gone down. In the late 1990s the HIV/AIDS pandemic captured the world's attention, with funding streams being diverted from SRHR to the response against HIV/AIDS.[10]

In 2000 189 heads of state and government committed themselves to the Millennium Development Goals (MDGs). Although the MDGs include promoting gender equality and empowering women, reducing child mortality, improving maternal health

1 Global Policy Committee of the WHO, 2 May 1994.

2 ICPD PoA, para. 7.16.

3 *Ibid*, Chapter VII.

4 *Ibid*, para. 13.15.

5 WHO (2005). *The World Health Report 2005. Make every Mother and Child Count.*

6 Report of hearings by the All Party Parliamentary Group on Population, Development and Reproductive Health: "Return of the Population Growth Factor: Its Impact upon the Millennium Development Goals". London, January 2007.

7 UNFPA and Alan Guttmacher Institute (2003). "Adding It Up: The Benefits of Investing in Sexual and Reproductive Health Care".

8 WHO (2004). *The World Health Report 2004. HIV/AIDS: Changing History.*

9 ICPD PoA, Chapter XIII, para. 13.15.

10 Report of hearings by the All Party Parliamentary Group, *op. cit.*

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and combating HIV/AIDS, malaria and other diseases, sexual and reproductive health and rights were not mentioned at all. Yet sexual and reproductive health and rights have an impact on practically all the MDGs.[11]

It is therefore clear that sexual and reproductive health and rights have an important role to play in achieving the ultimate goal of the MDGs: eradicating poverty. This was recognized at the World Summit in 2005, when the participants committed themselves to achieve universal access to reproductive health by 2015. They proposed a new target on reproductive health under MDG 5. However, this new target has not yet been finalized, due to the ongoing discussions around identifying appropriate indicators. This suggests that sexual and reproductive health and rights are still a controversial issue.

The African Union: a continental effort for sexual and reproductive health and rights

In view of the above it is heartening to see that countries of the African Union have recognized the need to move forward and take steps on guaranteeing their citizens' access to sexual and reproductive health care, a tacit acknowledgement that the African Union understands that poverty cannot be eradicated if sexual and reproductive health and rights are not addressed.

In September 2006 the ministers coming together in Maputo for a special session of the African Union adopted the Maputo Plan of Action for the Operationalization of the Continental Policy Framework for Sexual and Reproductive Health and Rights 2007-2010. In the Programme of Action the ministers agreed to take the continent forward to the goal of universal access to comprehensive sexual and reproductive health services in Africa by 2015. As key strategies they identified:

- Repositioning family planning as an essential part of the attainment of health MDGs.
- Addressing the sexual and reproductive health needs of adolescents and youth as a key sexual and reproductive health component.
- Addressing unsafe abortion.
- Delivering quality and affordable services in order to promote safe motherhood, child survival, and maternal, newborn and child health.
- Promoting African and South-South cooperation for the attainment of ICPD and MDG goals in Africa.[12]

For the financing of this ambitious Programme of Action the health ministers stated that the initiatives involved will be mainly financed through domestic resources.[13] These resources will be needed to strengthen health systems and improve basic public health functions, including community action and other necessary support functions.[14] Health workers need to be trained and the links between sexual and reproductive health care, the response to HIV/AIDS, malaria and other diseases need to be integrated in all health services. Gender-based violence, including sexual abuse, emergency contraception, HIV/AIDS post-exposure prophylaxis and STI treatment also need to be addressed in an integrated and coordinated manner. The ministers recognized the need to pay extra attention to youth, who are extremely vulnerable to HIV/AIDS infection and unwanted pregnancies, by putting youth-friendly services in place. The total amount of funding needed to implement this Programme of Action would be USD 3.5 billion by 2007 and USD 16 billion by 2010. So even though the ministers of health in the African Union acknowledge the importance of SRHR for their citizens, the ministers of finance still need to be convinced that investing in SRHR will have a beneficial impact on their economy.

Donors and governments: resources and political will

Donors, too, have not recognized the importance of funding for SRHR. The US still maintains the Mexico City Policy, also known as the Global Gag Rule.[15]

MILLENNIUM DEVELOPMENT GOALS

- MDG 1: **Eradicate extreme poverty and hunger:** High fertility levels contribute directly to poverty, reducing women's capacity to contribute to a household's income, diluting expenditure on children's education (and girls' in particular) and health, and increasing malnutrition as there are more mouths to feed.
- MDG 2: **Achieve universal primary education:** Families with fewer children and further spaced apart can invest more in their children's education.
- MDG 3: **Promote gender equality and empower women:** Women who plan the timing and number of their children have more opportunities to develop themselves socially, find job opportunities, get education and training and contribute to the economy.
- MDG 4: **Reduce child mortality:** Where modern contraception is below 10%, the average infant mortality rate is 100 deaths per 1000 live births. However where it is over 30%, the rate is 52 per 1000 live births. Moreover, children born too closely together have an increased risk of ill health.
- MDG 5: **Improve maternal health:** Preventing unplanned and high-risk pregnancies and providing care in pregnancy, childbirth and the postpartum period saves women's lives. Preventing unplanned pregnancies also prevents the need for (often unsafe) abortions.
- MDG 6: **Combat HIV/AIDS, malaria and other diseases:** Ensuring universal access to sexual and reproductive health would help combat HIV and AIDS. Preventing mother-to-child transmission can save the lives of thousands of children.
- MDG 7: **Ensure environmental sustainability:** reducing population growth will ensure less pressure on natural resources, including safe water.
- MDG 8: **Develop a global partnership for development.**

11 See also UN website on MDGs "Key Facts and Figures on Sexual and Reproductive Health" and UNFPA, "Reducing Poverty and Achieving the Millennium Development Goals".

12 African Union Conference of Ministers of Health (2006). Maputo Plan of Action for the Operationalization of the Continental Policy Framework for Sexual and Reproductive Health and Rights 2007-2010. Maputo, 18–22 September, art. 17.

13 *Ibid*, art. 19.

14 *Ibid*, art. 25.

15 In 2001, US President George W. Bush re-imposed restrictions known as the 'Global Gag Rule' (or the 'Mexico City Policy'). This policy mandates that no US family planning assistance can be provided to foreign NGOs that use funding from any other source to perform abortions in cases other than a threat to the woman's life, rape or incest; provide counselling and referral for abortion; or lobby to make abortion legal or more available in their country. This policy forces a cruel choice on foreign NGOs: accept US assistance to provide essential health services – but with restrictions that may jeopardize the health of many patients – or reject the policy and lose vital US funds, contraceptive supplies and technical assistance. For more information visit: <www.globalgagrule.org>.

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The challenge of quality health care

The availability and quality of essential health services represent major challenges for many countries of the South. Throughout this report there are countless examples similar to Kenya: health care providers in Kenya encounter a number of serious challenges to providing quality care. These obstacles include understaffing, lack of institutional support, and inadequate supplies and equipment, which invariably lead to lower-quality services for women and their babies. Hospitals often lack the most basic supplies, such as anaesthesia, gloves, syringes, surgical blades, soap and disinfectant, speculums and bed linens.

While, for instance, the European Union (EU), the biggest donor of development aid, had a separate budget line for Aid for Policies and Actions on Reproductive and Sexual Health and Rights in Developing Countries with a financial envelope of EUR 73.95 million for the period 2003-2006,[16] it has now, in 2007, incorporated this budget line in the health sector of a newly created financial instrument for the period 2007-2013 called ‘Investing in People’, meant to fund thematic programmes in the developing world. However, funding for SRHR will have to compete with many other issues which are to be funded through this thematic programme.

The EU also funds the developing countries through geographic programmes which are based on the so-called Country Strategy Papers, jointly drawn up with the recipient countries. However, here too SRHR are not identified as a separate focal area which means that funding will be very uncertain. It is ironic that this is happening in 2007, the halfway point of the MDGs, particularly since at the global level the introduction of a new target on MDG 5 acknowledges the pivotal role of SRHR in achieving MDG 1 on poverty eradication.

Conclusion

Although the ICPD Programme of Action was a first major step to raise awareness of the importance of sexual and reproductive health and rights and recognize them as a basic human right, the MDGs still need to fully incorporate universal access to sexual and reproductive health as a target under MDG 5. Funding for sexual and reproductive health and rights still lags behind at both the national and international level, although policies have been adopted. Many governments still need to be convinced of the important economic impact that a good sexual and reproductive health care system can have, as has been proven by examples from Mexico, Thailand and Egypt, for instance, where investing in family planning has meant extensive savings in public expenditure.[17]

It needs to be made clear that not only is universal access to sexual and reproductive health care services one of the most cost-effective ways of reducing infant and maternal mortality (medical gains), but it also has a huge impact on a woman’s personal life and her social and economic empowerment. Ultimately it also benefits a country’s economy, but most importantly, it is a human being’s fundamental right to live a healthy and satisfying sexual and reproductive life. ■

16 European Commission (2003). Regulation (EC) No. 1567/2003, 15 July.

17 Mexico: MXN 1 spent saved MXN 9; Thailand: USD 1 saved USD 16; Egypt: USD 1 saved USD 31. From: UNFPA and Alan Guttmacher Institute, *op. cit.*

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Population trends in the 21st century: Demographic bonus or demographic anchor?

Predictions of an acceleration in the ageing of the population over coming years have supported arguments for social security reforms in many countries, in general under a cloud of pessimistic forecasts about the future impact of ageing on pension systems. However, changes in the age structure of the population produce quite complex effects that entail not only problems but also opportunities. The utilization of these opportunities will not be automatic but will depend on the adoption of appropriate policies.

Daniel Ciganda
Social Watch Secretariat

Just as urbanization and the accelerated decline in fertility were the demographic processes which characterized the 20th century, the 21st century faces challenges posed by two demographic phenomena to which analysts and those responsible for designing policy are devoting a large part of their attention: population ageing and migration.

As a result of migratory movements during the 20th century, there are now 191 million people (3% of the world's population) living outside their country of origin. In the first few years of this century alone, between 2000 and 2005, the more developed regions received 13.1 million immigrants from the less developed regions.[1] The political, social and economic consequences of these movements have become one of the central issues on the agendas of the governments of the countries affected, either by the exodus or by the massive influx of migrants.

Although it is perhaps more silent, the other demographic process with profound present and future consequences for the possibilities of development of contemporary societies is population ageing. United Nations projections predict that by 2050 the number of people in the world over the age of 60 – which is currently approximately 700 million – will reach two billion. When that happens, the older adult population will exceed the population of children under 14 for the first time in the history of humankind.[2]

Although at present ageing is more marked in developed countries, the less developed regions are also undergoing accelerated changes. While it took the countries of the Organisation for Economic Co-operation and Development 75 years to double the percentage of persons aged 65 and over (from 7% to 14%), it is predicted that in countries with medium and low incomes, the transition will be effected in 30 years.[3]

It is fairly obvious that such transformations will have profound effects on social institutions in general and on social security in particular. However, the way in which these effects will make themselves felt is less clear.[4]

Transitions and opportunities

The changes in the age structure of the population resulting from the first demographic transition and their potential effects on economic growth have been widely analyzed. Basically, this process may be described as follows: the passage from conditions of high mortality and high fertility to those of low mortality and low fertility brings about a series of changes which may be classified in three stages. At first, the population is 'rejuvenated' through an increase in the proportion of children, since it is infants and children who most benefit from the decline in mortality rates. During the second stage, the proportion of children begins to diminish and that of adults and older adults increases as fertility continues to decline. After a period of low fertility and low mortality, the proportion of both children and of economically active adults diminishes and the process of population ageing begins.

The possibilities for development which emerge in the second stage – when the proportion of active adults is significantly greater than that of children and the elderly – have been labelled a 'demographic bonus' or 'demographic window of opportunity'. The increase in the working-age population should have positive consequences for the economy, not only due to the growth of per capita GDP but also to a greater collection of taxes. Essentially, this stage in demographic transition is a period of opportunities; it does not automatically lead to greater growth or development, but it could if the necessary measures and policies are implemented.

Although this window of opportunity is already closed in regions where development is more advanced, Latin America and the Caribbean and Asia are at a stage of the transition where they could still take advantage of these favourable conditions. In several African countries the situation is somewhat more complex, since the transition to lower mortality rates has been interrupted by the incidence of HIV/AIDS.[5] However, as several of this year's Social Watch national reports show, the majority of these countries do not enjoy the necessary conditions with regard to education and employment to allow them to take advantage of the opportunities offered by the current active/passive population ratio.

Those responsible for designing public policies are rarely heard stressing the need to create the employment conditions necessary to benefit from this window of opportunity. Far more common are the pessimistic predictions of the future effects of population ageing. The prospect (or concrete experience) of demographic ageing processes has sparked concerns over the viability of health care and social security systems. In many countries, these concerns have been used to justify reforms of systems based on intergenerational solidarity and their replacement with systems based on personal savings.[6]

According to the Social Watch Italy report, for example: "The need for drastic reform of the public and compulsory pension system due to its financial unsustainability is an issue that began to have major public resonance at the beginning of the 1990s. There are basically three factors used as 'proof' of this necessity: serious accounting imbalances in the Italian Institute of Social Security (INPS), population ageing, and the forthcoming retirement of the so-called 'baby boom' generation."[7]

However, the arguments behind most social security system reforms disregard the fact that any kind of system requires economic growth to make it sustainable. Moreover, to consider the effects of ageing exclusively as a 'burden' is to forget that the increase in life expectancy goes hand in hand with an increase in years of a healthy and active life. Nor are there valid arguments to back

1 *International Migration 2006* (poster). United Nations Department of Economic and Social Affairs (DESA), Population Division.

2 *World population prospects: the 2004 revision.* United Nations, DESA, Population Division, 2005.

3 Sigg, R. (2007). "A Global Overview on Social Security in the Age of Longevity". In *United Nations Expert Group Meeting on Social and Economic Implications of Changing Population Age Structure.* United Nations, New York.

4 In order to shed light on these issues and adopt measures to address the current and future situation of older adults, some voices have begun to call for a UN Convention on Ageing, taking into account the results of the Second World Assembly on Ageing. See the chapter by Susanne Paul and Alischa Kugel in this Report.

5 See the box on HIV/AIDS in Asia, Africa and Latin America in this Report.

6 For a detailed analysis on the role played by the World Bank as principal promoter of these reforms, see the chapter by Antonio Tricarico in this Report.

7 Similar situations are described in other national reports, such as those from Malta, Spain and Germany, where the effects of ageing have been clearly perceptible for a number of years.

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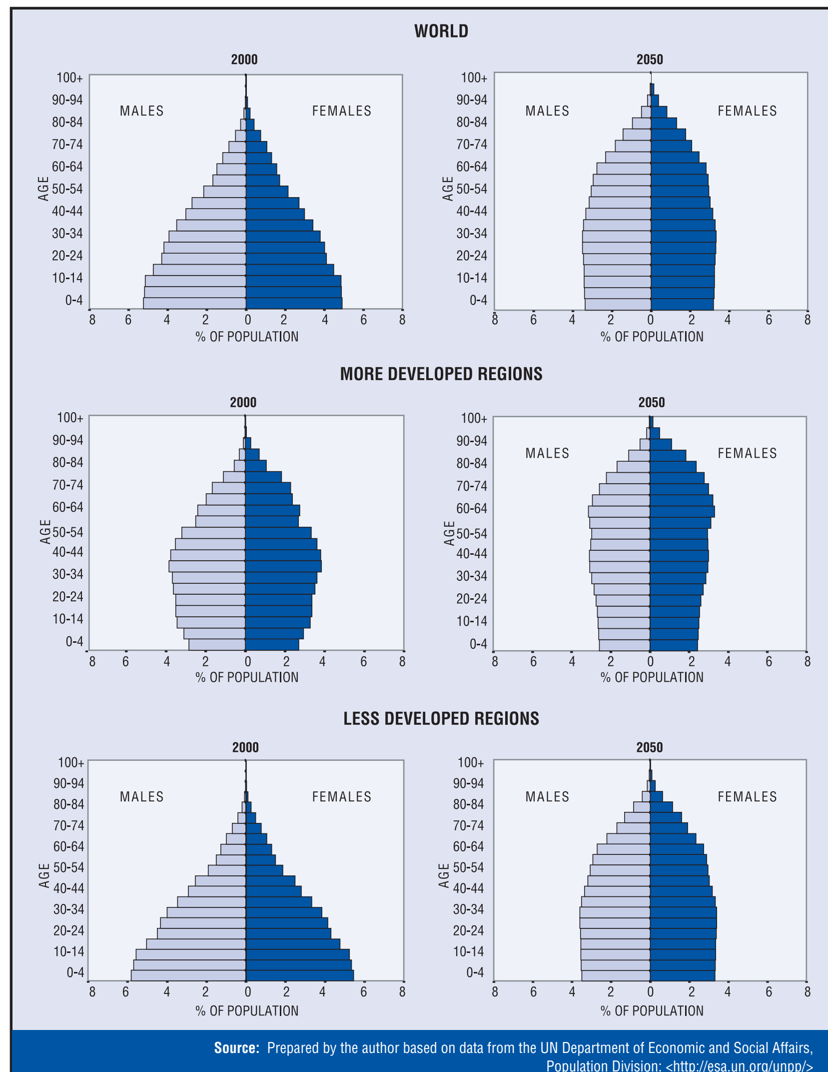

Source: Prepared by the author based on data from the UN Department of Economic and Social Affairs, Population Division: <http://esa.un.org/unpp/>

the claim that an increase in productivity cannot compensate for the greater cost of the pension system – especially since this has been the case until now in the developed countries. As underlined by the Social Watch Spain report: "In spite of the frequent predictions that the pension system is headed for collapse, the fact is that since 1998, the Spanish social security system has actually accumulated a surplus."

Furthermore, some researchers have suggested the possibility of a 'second demographic bonus' linked to the process of ageing. The basic idea is that, provided that the increase of the retirement age entails greater savings on the part of individuals, the state and/or companies, subsequent investment of that capital in order to finance consumption during the non-active years will cause the economy to grow faster than if those savings did not exist.[8]

Although this is an interesting idea inasmuch as it shows a possible positive effect of ageing, in current conditions the saving possibilities of most of the world's population are more than limited. In fact, more realistic projections regarding private saving capacity have served to back the call for implementing other solutions, such as a global old-age pension. "There is still significant pensioner poverty today but matters will become much worse by 2030 and 2040 as already enacted reductions in entitlement come into effect. Supposedly private savings, and new efforts by the financial services industry, will make up for this shortfall, but exorbitant charges and tempting information gaps between supplier and customer virtually rule this out, as official projections themselves reveal. If private financing of pensions fails in the rich countries because of cost rations and unequal information, its contribution in poor countries will be even more disappointing."[9]

However, the limitations of private savings do not appear to be the only difficulty with regard to mitigating the effects of decreased income after retirement. The way in which reforms have been undertaken is also problematic, as pointed out by the Social Watch Malta report: "The longevity risk is shifted squarely to the shoulders of individual contributors of the same generation and not borne by the state, since the move to a direct contribution scheme shifts the financial risk of changing economic and demographic factors from the state to the individual. Taken together, all these measures tend to disadvantage those with low lifetime earnings..."

None of these arguments attempt to deny the need to reform the health care or social security systems, but rather to challenge the arguments that focus exclusively on predicted shortages and their purported effect on financial sustainability. In other words, the ability to forecast future scenarios should not lead to the adoption of desperate measures based on the most pessimistic predictions, but to a search for viable and solidly grounded alternatives that create the conditions to take advantage of the opportunities offered by the first or second 'demographic bonus'.

The most effective measures for achieving this aim will depend not only on the particular stage of the demographic transition in which individual countries or regions find themselves, but also on a series of contextual factors. Therefore, any proposals must be based on detailed analyses of specific national and regional conditions, such as those presented in the national reports in this year's Social Watch report. In short, while the prediction of medium and long-term population trends is a fundamental input for planning, whether these trends are translated into development opportunities or obstacles ultimately depends on the policies adopted. ■

8 Mason, A. (2007). "Demographic transition and demographic dividends in Developed and Developing countries". In *United Nations Expert Group Meeting on Social and Economic Implications of Changing Population Age Structure*. United Nations, New York.

9 Blackburn, R. (2007). *Building Equality from the Ground Up: An Outline Proposal for a Global Pension (and Youth Grant).* In Lawrence & Wishart, <www.lwbooks.co.uk/journals/articles/blackburn207.html>.

Social protection for older people: A plan of action

In 2002 the UN World Assembly on Ageing adopted a Plan of Action aimed at guaranteeing senior citizens a decent livelihood. At the time, the governments of 159 countries agreed on policy objectives but failed to make binding commitments. Even so, countries such as Bolivia, Tanzania and Bangladesh have made great progress on this issue. There is still a long way to go and the next step seems to be a UN convention on senior citizens.

Susanne Paul
Alischa Kugel [1]
Global Action on Aging

The revolution of long life is now upon us. In most countries of the world, until very recently, half of all human beings died before the age of 20. Only a handful lived to see the birth of their grandchildren. But today, more and more people are living very long lives.

According to United Nations (UN) projections, persons aged 60 years or older will number almost two billion by 2050. Older people will exceed the population of children, marking an unprecedented event in human history. Developing countries will experience the most rapid growth of the world's older population.[2]

The ageing of populations is a human milestone that reflects better public health and nutrition, but the shift brings new policy issues to the fore. Particularly, there is the question of how older persons sustain themselves as they live past the period of active work. The UN estimates that today 140 million older persons, particularly older women, are living on the equivalent of less than USD 2 per day.[3]

Older people are among the poorest of the poor for several reasons. Traditional family support is declining in virtually every country. Having worked for subsistence or very low wages, few elderly people have savings or other resources of their own for old age. Nor do they have access to job-based social protection benefits. Also, they may suffer from disabilities such as sight or hearing loss that restrict their ability to work. Elderly widows may face particular disfavour and discrimination in their communities.

Paradoxically, older women often have important care-giving responsibilities. They may be raising grandchildren or taking care of sick, middle-aged children in communities hit by the crisis of HIV/AIDS. Or they may be supporting grandchildren whose parents have left for jobs in distant places. As sole breadwinners, these grandparents may find themselves unable to provide adequate nutrition, access to health care or education for their children, grandchildren or themselves.

One grandmother in a village in Africa described her situation this way:

> When we don't have food, I put a pot with water on the fire. When my grandson asks for dinner, I say it's cooking, hoping that he will fall asleep fast enough so he doesn't find out.

The Madrid International Plan of Action on Ageing

In April 2002, the UN World Assembly on Ageing in Madrid took up the question of how older people can be assured a decent livelihood. Governments of 159 countries adopted the Madrid International Plan of Action on Ageing (MIPAA), a policy document that offered many suggestions including income security, social protection and poverty prevention.[4]

In the MIPAA negotiations, governments supported policy 'objectives,' but they refused to accept binding commitments. As a result, the agreement has little legal force, even though it sets norms and offers important original policy ideas.

The MIPAA spoke about social protection and gender issues. The Plan addressed informal sector work and called for 'innovative' programmes of income support. It urged a minimum income for all older persons, in the form of non-contributory, government-funded pensions.

The concept of a 'social pension' was one of the most innovative and influential parts of the Madrid Plan. Since the adoption of the Plan in 2002, an increasing number of countries have set up social pensions.

Activists and NGOs involved in the worldwide campaign Grow Up Free From Poverty[5] seized on social pensions as a new policy tool. Advocates focused on social pensions for several reasons:

- A minimum income can lift older persons out of poverty and increase their access to social services, such as health care.
- Older persons, who often live with their families, share their income with the household. Social pensions raise the overall family standard of living, and improve nutrition and access to education for children.
- Social pensions support older persons who act as care-givers of orphans in the AIDS crisis.
- Social pensions help break the intergenerational poverty cycle.

In addition, social pensions are comparatively affordable for governments to implement. Along with the 72 high- and middle-income countries that have implemented social pensions, there are also several poor countries, such as Bangladesh, Bolivia, Lesotho and Nepal. In 2006, 13 African nations met in Zambia to draw up and adopt the Livingston Agreement to institute social pensions.[6]

Studies by NGOs and UN agencies illustrate the affordability of these programmes. HelpAge International surveyed 18 low- and middle-income countries on the cost of social pensions. The study found that nearly 70% of those surveyed could deliver a social pension for less that 1% of gross domestic product (GDP). The International Labour Organization (ILO) also concluded that poor countries can afford basic social protection packages, especially if rich countries provide transitional financing assistance and if the implementing country makes a strong national policy commitment. Even the World Bank is a convert. After years of avidly opposing public pensions in favour of private, contributory schemes, the Bank has recently started to promote social pensions.[7]

Thanks to this increasing policy consensus, rich countries have begun to give development assistance for social protection, including social pensions. Among the funders are the Nordic countries, Germany, the United Kingdom, France and Belgium. UNICEF, the UN Children's Fund, has also provided funding, in recognition of the potential of social pensions to help families and children.

Despite this growing support, the MIPAA agreement itself lacks firm legal commitments and campaigners cannot demand social pensions as an

1 Susanne Paul is president and founder of Global Action on Aging, an organization devoted to the social and economic well-being of older persons worldwide. She has worked on global aging issues in the UN NGO community in New York since1984. Alischa Kugel, program coordinator, has developed research and materials on MIPAA implementation for GAA since 2004.

2 "Population Ageing, 2006" (poster). United Nations, Department of Economic and Social Affairs, Population Division, p. 1.

3 Kugel, A. (2006). "Report on the UN International Forum on the Eradication of Poverty". November, p. 1. Available from: <www.globalaging.org/elderrights/world/2006/povertyforumreport/pdf>.

4 "Report of the Second World Assembly on Ageing," Madrid, 8-12 April, 2002, A/CONF.197/9 (23 May 2002).

5 <www.grow-up-free-from-poverty.org>

6 HelpAge International News (2006). "African Governments Take Action on Social Protection". Zambia, 28 March. See: <www.globalaging.org/pension/world/2006/helpagepensionsafrica.htm>.

7 See the specific reports about World Bank policies on social security developed by Antonio Tricarico and BGRF in this Report.

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acquired 'right.' This voluntarist approach at Madrid was a backlash from the UN World Conferences of the 1990s – including the conferences on the environment, human rights, population, social development, and women. NGOs had demanded (and sometimes won) timetables and specific goals. These egalitarian programmes proved difficult for governments to fund and implement because of pressures for tax reduction from companies and wealthy citizens. This led to many conflicts and embarrassments, which governments wanted to avoid in future. Consequently, rich and poor countries alike resisted further binding commitments, especially in the ageing sector, perceived as being potentially very costly. Governments clearly did not want NGOs or citizens to 'name and shame' them for failing to implement the MIPAA.

During the Madrid negotiations, some delegations tried to water down every article to its least binding form of language. Washington, with the Bush administration in office, insisted vocally on a non-binding route. Governments firmly resisted NGO demands for stronger language and most delegations strongly opposed references to extra financing. In the end, governments decided that the Commission for Social Development, with UN Secretariat assistance, would review the Plan's implementation after five years.

The UN Secretariat staff later devised a 'bottom-up approach' to the review. Crafted to avoid 'name and shame' confrontations, the bottom-up approach sidesteps government responsibility and puts most of the follow-through burden on older persons themselves and on their presumed grassroots organizations from the 'bottom of society'. These people and organizations are expected to find other partners, create services, organize advocacy organizations, set up programmes, pressure the governments and articulate the needs of older persons. At its best, older persons and their allies would suggest ageing policies and governments would respond positively. The plan shifts most responsibility from the state to 'civil society'. Considering the meagre resources available in most affected communities and the general absence of such local organizations, this approach tends to slow action. And by failing to establish a mandatory international reporting and review system, it contributes to ignorance of the agreement within governments, NGOs and even the UN itself.

Some countries have nonetheless made progress, most notably poor countries. In 2002, Bolivia decided to develop better data about age and gender to make its social pension programme work more fairly. In 2003, Uganda committed to develop a social pensions system and ruled that all government departments must pay attention to nutrition and health for the elderly. Tanzania set a goal to extend social pensions to 40% of its older citizens. NGO campaigns helped promote this progress. In 2005, a Bangladesh older persons' monitoring group took the government to task for not paying the Old Age Allowance to all eligible older persons; as a result the government extended payments to 300,000 more elderly.[8]

During the post-Madrid period, the UN's Regional Economic and Social Commissions encouraged governments to adopt national ageing programmes and to improve data, resources, and reporting. The commissions in Asia, Latin America and Europe were especially active.

The UN Programme on Ageing in New York sought special funding from the UN system and cooperated with other UN agencies to offer training for government officials in a number of low- and middle-income countries. UN staff also gave on-site support to governments developing national ageing plans. In February 2008, the Commission on Social Development will review how governments have implemented the MIPPA, providing another opportunity for forward motion.

The way ahead

The five-year experiment with the MIPPA has spotlighted useful programme initiatives and alerted some countries to the potential among their older population. However, much remains to be done.

Even though the UN review process is weak, the global crisis of poverty has forced a policy shift toward social protection, both among governments and among intergovernmental institutions. Most recently, in May 2007, the G8 labour ministers promised to address the "need to develop social protection" and "international labour standards."[9] Governments of many rich countries now see social protection positively, opening a new policy space for social pensions and other kinds of social protection for older people.

In this context, the UN may be able to develop policies for universal social protection for older persons. Governments might even be willing to mandate this in a new binding agreement. A UN Convention for Older Persons could accomplish this goal. People of all ages would understand that protecting their grandparents and parents would also mean protecting themselves in their own later life. A healthy, long life, with access to subsistence and health care, should be available to all. Using the Madrid Plan's recommendations on social protection as a model, a Convention could make great strides in this direction.

Social rights advocates in poor and rich countries must join together in a movement to press for a UN Convention for Older Persons. We need the experience and input of all peoples and regions to create such a document, insuring to all the right to social protection. In the meantime, advocates can help make the MIPAA more widely known and use it to advocate for a UN Convention. Governments of 159 countries made commitments to older people in 2002; let's hold them to their word. ■

8 UN Department for Economic and Social Affairs (2006). "Guidelines for Review and Appraisal of the Madrid International Plan of Action on Ageing, Bottom-up Participatory Approach". New York, p. 36-49.

9 "Shaping the Social Dimension of Globalization," May 2007, p. 1, 4. See: <www.globalaging.org/elderrights/world/index.htm#articles4>.

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How to implement a global old age pension and youth grant

Both the vulnerable situation of senior citizens and predictions for the ageing of the population call for the implementation of a global old age pension. This should be accompanied by a youth grant system, thus supporting the two age groups in the most fragile situations and fostering intergenerational justice. The effective application of global taxes such as the Tobin tax on international transactions could provide financial viability for such programmes and promote wealth redistribution and more transparent and responsible corporate behaviour.

Robin Blackburn[1]

The universal, publicly financed old age pension has been a popular and effective means for reducing poverty and extending social citizenship in all developed states.[2] In the age of globalization it is right that the old age pension, this tried and tested device for protecting the livelihood of the elderly, should be installed at a global level, by means of a pension paid at a modest rate to all older persons on the planet, to be financed by a light tax on global financial transactions and corporate wealth.

In the first instance the global old age pension could be set at one dollar a day, bearing in mind that even this small sum would help to lift hundreds of millions of the aged out of poverty in every part of the globe. Poverty is still strongly associated with old age, and especially with gender and old age. State pension schemes greatly help to limit old age poverty in the developed world, but have not abolished it, while in developing countries pension arrangements often reach less than a quarter of the population.

The usual link between pension entitlements and employment contributions is not good for women. Because women live a few years longer than men, the majority of the elderly are women. And because women's unpaid labour in the home counts for little in public pension systems, and for nothing in private and occupational schemes, over three quarters of the elderly poor are female. Moreover, a woman's work of caring for other family members typically continues in old age, as she cares for her spouse, her grandchildren and the sick. In countries afflicted by HIV/AIDS, older women are essential to family survival as they take on their children's parenting role. If a reliable way could be found to channel USD 30 a month, or USD 90 a quarter, to the aged in the developing countries, this would not only massively reduce poverty, but would put resources in the hands of those who could make good use of them.

In richer countries there are still stubborn pockets of poverty among the aged – especially older women. As the older population grows in size, and employers and the state cut back on provision, these pockets of poverty will increase. A cheque for USD 90 a quarter would not banish poverty in the economically advanced countries but it would be welcomed by many of the elderly, making a modest but useful contribution to their straitened budgets.

There are some 560 million older women and men in the world today – that is, persons over 65 in the developed countries and over 60 in the developing world. The cost of introducing a global pension of a dollar a day in the next few years would be around USD 205 billion a year, one fifth of the projected cost to the US of the Iraq War, or one half of the annual US military budget prior to the Iraq invasion. However the cost of the proposed pension will double by around 2030, and treble by mid-century. Ageing is going to climb steeply in coming decades because of rising longevity and a falling birth rate. These trends are not confined to rich countries. Just as urbanization occurs with or without economic development, so does ageing of the population. While the former process is leading to 'a planet of slums', the latter is making for a global blight of destitution in old age.

As Susanne Paul and Alischa Kugel detailed in their report, by 2050 the UN Population Division expects there to be two billion persons aged 60 or over worldwide, with 1.6 billion of these in the less developed countries.[3] Ageing is most marked in Europe and Asia but it is advancing elsewhere too. By 2050 the size of this older group in Africa is set to quadruple to reach 207 million, comprising 10.3% of the total population. Africa will have more older persons than Latin America and the Caribbean (with 187 million aged 60 and over), and nearly as many as Europe (with 229 million of that age). By 2050 Asia, a category that includes India and China, is expected to have no less than 1.249 billion older persons, comprising a fifth of the total population in India and as much as 28% in China.

It is often claimed that the ageing of the population can be offset by immigration. The projections quoted[4] assume the continuation of current trends in migration. While migration flows can temporarily mitigate the ageing effect in recipient countries, they cannot, of course, reduce the ageing of the global population.

Today women comprise 55% of those aged 60 and above worldwide, 65% of those aged 60 plus in North America and 70% of those aged 60 plus in Europe. Worldwide, women comprised 63.5% of those aged 80 and above in 2005, a figure that is expected to drop slightly to 61.4% by 2050. The frail and vulnerable 'old old' are the most rapidly growing age cohort in all parts of the world. There were 88 million persons aged 80 and above worldwide in 2005, a figure that is projected to rise to 402 million by 2050 according to the UN Population Division mid-range projections.

The ageing trend will already be evident long before 2050. India's over-60 cohort will number 175 million by 2024. By 2040 there are expected to be 98 million persons aged 80 plus in China, 47 million in India and 13 million in Brazil. These people are all already born, a circumstance that gives the projection a high degree of probability.

There are very few countries in the world which have arrangements adequate to the rising future need for the care and support of the elderly. In the developing world and poor countries the aged are often sunk in absolute or extreme poverty, while in the richer countries they suffer relative poverty. As aged populations double or treble both these problems will grow. Worrying as the economic outlook is for the elderly in most of the OECD countries, the situation is, of course, worse in the former Soviet Union and much worse in many parts of Asia, Africa, and Latin America where the aged in the countryside and the slums often have no coverage at all – circumstances which could themselves supply their own grim corrective to the assumption that recent improvements in life expectancy will be maintained.

According to one estimate formal retirement income schemes cover fewer than 15% of the world's households. Even states like India and Chile, with growing economies and considerable administrative capacity, fail to deliver basic pensions. Chile's pension system has been held up as a model, yet leaves 40% of the population entirely uncovered, and

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2 This report is based on a presentation given at an event organized by Global Action on Aging at the United Nations building in New York on 14 February 2007, for the benefit of those attending the concurrent meeting of the UN Economic and Social Council.

3 These estimates are taken from the 2006 revision to be found on the website of the UN Population Division. See: <www.un.org/esa/population/unpop.htm>.

4 See also the demographic trends box in this Report.

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furnishes weak coverage to another 40%.[5] India's old age pension is means tested and amounts to only USD 2 a month for those able to claim it. While poor urban dwellers are not poor enough to claim, poor rural dwellers find it too costly.[6] As populations age further this places great strain on the elder care arrangements in family and kinship networks.[7]

Poverty and inequality are so great in today's world that quite modest remedial measures can have a large impact. There are 2.5 billion people living on less than USD 2 a day, with the majority of the elderly falling within this category. Meanwhile, the richest 10% command 54% of global income. In this 'champagne glass' world, the well-off sip at the glass's brimming bowl, and the impoverished or struggling remainder supply the slender stem. In such conditions, a dollar a day is less than a rounding error to the wealthy, yet would be a lifeline to the global aged poor.

The plight of the old and the claims of youth

Urging the case for a global pension is not meant to slight either the humanitarian approach, which prefers simply to urge the claims of bare humanity, or the efforts of those who campaign for the need to alleviate the problems and poverty of specific groups, such as young mothers or people living with HIV/AIDS. In the unequal and strife-torn world in which we live there are several, or many, ways in which poverty may be overcome. Peace would be the best help for the very poorest in strife-torn lands. Then there is successful economic development, such as has taken place in China and India over recent decades, which will lift many out of poverty and furnishes a more hopeful context in which to advance anti-poverty strategies. But the weakness of provision for the elderly in these states also shows that even – or especially – the most rapid growth may not banish absolute poverty, in the countryside or new urban centres.

So a global pension could command support in ways that would extend the general case against poverty. In the richer countries there is fear of pension failure at home, and concern at the worse plight of the very deprived in the poor countries. In the developing countries there is the more specific alarm or guilt that is occasioned by the poverty, actual or impending, of parents, grandparents, uncles and aunts. Such sentiments helped to generate support for old age pensions in the developed states in the past and are likely to do so again in the developing world. A global old age pension, if it could be realistically financed and delivered, would enjoy substantial legitimacy and would in no way detract from other efforts to combat relative or absolute poverty. This is already the case, but that legitimacy can only grow in an ageing planet. Today the majority of the old are poor; tomorrow the majority of the poor may well be old.

While we must help the aged, it would be wise also to extend similar help to the other age cohort which is typically excluded – young people. The global pension should be twinned with a youth grant. Older people themselves would feel happier to receive a pension if financial help was also available to the young, especially the sort of help that would allow them a better start in life. Today one half of those aged between 16 and 24 are unemployed – not in a job and not receiving education – and thereby at special risk of being in poverty both now and in the future. If we set aside a small privileged minority in both categories there is reason to see young adults and the elderly as the excluded generations.

The cost of supplying every younger person with USD 1,500 for educational and training purposes on reaching the age of 17 would be very similar to that of paying the global pension of a dollar a day. A youth grant would widen access to the knowledge society and symbolize a concordance of the generations. While it could transform the possibilities of the young person in poor countries, it would still be welcome to most of the young in wealthier lands. Young people are now greatly burdened by the rising cost of acquiring skills and education. They also tend keenly to appreciate any extra modicum of independence from their parents. Even in some of Europe's most advanced welfare states, such as Sweden, young people living on their own figure disproportionately in the poverty statistics. The case for special help to the young is now so widely acknowledged that it does not need further pleading here.[8] The question remains: how could financial help to the 'excluded' generations be financed?

How to pay for the global pension and youth grant

Only USD 205 billion a year would be needed, to begin with, for the proposed global pension. But it would be necessary to reckon with the need for a more than doubling of revenues within a generation and the building of a substantial fund now, while ageing effects are still comparatively modest, to help finance extra pension pay-outs in the middle decades of the century. Moreover, there should be a commitment to raise the global pension in line with the growth of overall average incomes so that the old share in future prosperity.

Raising the necessary finance for a global pension – together with something extra for administrative costs – will certainly require a serious effort. The fiscal devices adopted should ideally relate to the workings of the global economy taken as a whole, so there would be a wide and dynamic tax base.

Three types of impost are peculiarly well suited to such a task: a tax on international currency transactions, a tax on the fuel used on international flights, and a very mild tax on corporate wealth. The calculations which follow are simply rough-and-ready exercises designed to establish that the pension and grant can be easily financed by the proposed taxes, and have the further benefit of shedding much-needed light on international financial flows.

The famous Tobin tax applies to the sale or purchase of currencies and has been urged as a measure to curb currency speculation.[9] But it could be applied mainly as a revenue-raising measure. Set as low as 0.1% – or one thousandth part of each transaction – the tax would not be worth evading but would still raise large sums globally. Common estimates of the amounts that could be raised each year from a Tobin tax on currency transactions ranged from USD 100 billion to USD 300 billion in the late 1990s. By 2010 the Tobin tax yield should comfortably reach the higher end of this scale – USD 300 billion.

The suggestion here is that income of around USD 150 billion be earmarked as the Tobin tax contribution to financing the global pension, with the remainder to be dedicated to young adults – the young could be offered a lump-sum grant of USD 1,500 to use for education or training when they reach the age of 17. Small as this sum would be in richer societies, it would not be a negligible one. Twinning the global old age pension with help for young people would begin to assert a new balance

5 See the private pension funds box, with Chile's details and several examples, in this Report.

6 The yawning gaps in pension provision are well documented in Larry Willmore, "Universal Pensions in Developing Countries", *World Development*, Vol. 35, No. 1, 2007, p. 24-51. For India see Rajeev Ahuja, "Old Age Income Security for the Poor", *Economic and Political Weekly*, 13 September 2003.

7 This strain is described in Jeremy Seabrook, *A World Growing Old*, London, 2003. Further information on the precarious situation of the old in developing societies is to be found in the UN Department of Social and Economic Affairs, *World Economic and Social Survey 2007, Development in the Ageing World*, New York, 2007, especially p. xiv, 93-5.

8 The special claims of youth are urged by Bruce Ackerman and Anne Alstott, "Why Stakeholding" and "Macro-Freedom" in Bruce Ackerman, Anne Alstott and Philippe Van Parijs, eds., *Redesigning Distribution*, London, 2006, p. 43-68, 209-16. A policy for a type of youth grant is also made by Roberto Mangabeira Unger in his book, *What Should the Left Propose?*, London, 2006, p. 43-67. For information on youth exclusion see the World Bank's *Annual Development Report 2007*, *Development and the Next Generation*, Washington, 2007.

9 For the Tobin tax see James Tobin, *The New Economics*, The Elliot Janeway Lectures in Honor of Joseph Schumpeter, Princeton, 1974; J. Frankel, "How Well Do Foreign Exchange Markets Function: Might a Tobin Tax Help?", NBER Working Paper No. W5, Cambridge, MA, 1996; Keiki Patomaki, *The Tobin Tax: How to Make It Real*, The Finnish Institute for International Affairs, Helsinki, 1999; Joseph Stiglitz, *Globalization and its Discontents*, New York, 2004.

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between life stages in a scheme of generational equity. However, such a justified sharing of Tobin tax revenues would mean that another source of funds would be needed for the global pension, especially as the ageing of populations grows in the future.

At present the fuel used on international flights is almost untaxed and costs the airlines about USD 50 billion a year. A doubling of the price of fuel might help to cut consumption by a fifth or a quarter while still raising USD 30 billion. However, much of the yield from green taxes should be used to invest in other measures designed to mitigate global warming. But tying at least some of the revenue – say a half of it – to a universally recognized good cause would be defensible. While USD 15 billion a year would be a help, other sources of revenue would still be needed.

The third source of revenue is a mild levy on share values or share transactions. There could be a requirement on all companies employing more than 50 employees, or with a turnover of more than USD 10 million, to pay a tax of 2% on their annual profits, to be paid either in cash or, in the case of public companies, by issuing new shares of that value to the fiscal authority (private companies could issue bonds, and partnerships, including private equity partnerships, could issue nominal partnership rights). All genuine pension funds would be compensated for the impact of share dilution on their holdings.[10]

Two important features of these arrangements should be noted. Firstly, they would apply to profits made anywhere in the world. Secondly, companies would be able to discharge their obligation simply by issuing a new security rather than by subtracting from their cash flow. Large US and UK corporate pension fund sponsors have complained about the burden of making cash payments to the Pension Benefit Guaranty Corporation and the Pension Protection Fund, the insurers of their 'defined benefit' pension schemes. In some cases companies have been in such difficulties that such payments were impossible. This has led US 'chapter 11' bankruptcy-protection courts to require the issuance of new shares as an alternative way of making a contribution to their insurer. In the UK the Pensions Regulator has made similar provisions requiring cash-strapped companies to issue shares to the Pension Protection Fund.[11] Employees will stand to qualify for the new pension but would certainly welcome a type of contribution that does not weaken their employer in any way.

The profits tax/share levy would be at a very low rate – a tax of 2% of profits should raise about USD 140 billion annually. The share levy briefly sketched has been set at 2% of profits, but this is simply a convenient way of measuring a company's operations and might need to be supplemented by other metrics to avoid distortions aimed at evasion. The share dilution brought about by the levy means that even funds in tax havens would not escape.

Before returning to calculations of the contribution of a share levy to financing the global pension it is pertinent to mention a financial tax that has a long history, and has been highly successful, namely stamp duty, a tax on share transactions. Stamp duty in the UK shows that a very modest charge on a large volume of transactions can yield large sums at a low cost and without harmful side-effects. Levied at a rate of 0.5% of share transactions (other than those by market makers) the UK stamp duty raises over USD 5 billion annually. While derivative contracts pay no stamp duty, any sale of underlying shareholder assets does attract the tax. The Confederation of British Industry, a business lobby, argues that the stamp duty is weakening London's position as one of the world's leading financial centres. But the thriving state of London finance belies the argument. The UK Treasury is anyway greatly attached to an impost that is easy to collect – this is done at very low cost as part of CREST, the central share settlement system.

China's financial authorities have a similar device which they use in a 'Tobin tax' way to dampen speculation – but it also raises large sums.[12] Several European states, including Switzerland and France, have similar very mild imposts, applying to bonds as well as shares. In case of any shortfall in the yield of the taxes already suggested, or of implementation difficulties, a global stamp duty or FTT (financial transaction tax) could be looked at to fill the gap.[13]

It will be recalled that a half-share of the Tobin tax already raises USD 150 billion towards the global pension, and that the fuel tax on international flights should raise a further USD 15 billion annually. Thus, to begin with, an extra USD 40 billion a year would be needed from the share levy (or share transaction levy), to meet the immediate annual cost of USD 205 billion. This would allow the remainder of the sum raised by the share levy on profits – USD 100 billion each year – to accumulate in the Global Pension Fund (GPF) network as a strategic reserve pledged to meet the anticipated rise in the numbers and proportion of the aged.

The various taxes would be collected by national fiscal authorities with assistance from appropriate international bodies such as the International Monetary Fund (IMF) and the International Air Transport Association (IATA). Revenues would be paid to the global office of the GPF for consolidation with the world fund.[14]

Consolidation of assets by an international agency would ensure a highly diversified portfolio but the agency would itself be required to distribute the assets it receives to a global network at regular intervals. This regional network of around a thousand local offices of the GPF would be responsible for paying the pension and would receive resources in line with their region's demographic characteristics. In the interests of building up its reserves, the GPF network would use its cash revenue to pay out current pensions but hold all the new shares and other securities to generate larger revenues in the future, when they will be needed.

A global network of reserve funds

During an initial accumulation phase it might be wise to reinvest dividend income in public bonds. Because the GPF network would not buy or sell shares it would have less scope for making mistakes. The knowledge that the GPF network would not sell the shares it held would also be a factor of stability and would prevent it from financially harming the companies in which it had stakes. By around 2034 total assets in the GPF network could amount to USD 7.7 trillion.[15] If cash pay-outs began at this time, and the annual yield on capital was around 3%, this would be USD 257 billion for that year. Each regional office would hold around USD 7.7 billion in assets and receive USD 257 million in revenue. Note that while dividend income can fluctuate, it is less volatile than share price, and there are ways of smoothing such receipts.

The global pension would be a universal scheme benefiting everyone who reaches old age. The receipts of the currency-exchange tax and the levy on profits would obviously be larger in rich parts of the world than in poor ones. However, currency transactions and corporate profit trails often involve tax havens and developing states where income per head is still low. The currency tax and the profits tax would be light but they would apply everywhere. The overall workings of the global pension – if financed in the way suggested – would redistribute from rich to poor. On the other hand, the participation of every

10 The use of a general share levy to establish reserve social funds is associated with the work of Rudolf Miedner, the chief economist of the Swedish trade union federation, the LO, and architect of the Swedish welfare state. There is a fuller account of its workings in the sixth chapter of *Age Shock*, *op. cit.*

11 More examples of this court-mandated share issuance from the author in *Age Shock*, *op. cit.*, p. 134-5, 142. The judges were no doubt in part prompted to take this measure because of records of corporate irresponsibility which are documented in chapters 2 and 3 of this book.

12 See Geoff Dyer and Jamil Anderlini, "Beijing Could Reap USD 40bn Share Tax Bonanza", *Financial Times*, 4 June 2007.

13 See also the article by John Christensen in this Report.

14 The GPF might maintain offices in such important financial centres as Zurich, Cyprus, Mauritius, Singapore, and so forth, chosen with a view to strengthening compliance.

15 There is an assumption that profits rise at 2.5% a year and that returns of 5% a year are ploughed back into the fund for an 'accumulation period' of 27 years. Further details in chapter six of *Age Shock*, *op. cit.*

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territory – no matter how small or poor – would be essential to the effective workings of these levies.

Citizens of richer countries should be pleased at the comprehensive scope of the new arrangements, which would require potential or actual tax havens to report currency movements and profits at companies they allow to register in their territory. The global pension would give those in richer countries rights to a modest pension supplement, and as a flat-rate benefit would help the less well-placed more than the comfortably-off everywhere. It would do most to reduce poverty where it is worst: in the countryside and neglected urban areas of the developing world. Last but not least it would promote more transparent and responsible corporate behaviour and nourish a worldwide organization dedicated to social welfare.

The regional network of funds would be bound by actuarially fair rules of distribution and would be required to hire professionally qualified personnel, but should also furnish democratic representation to local communities. The holding of stakes in a great variety of companies could in principle give the regional network a say in how these shares would be voted. The impact of the network on the management of any given company would be very small, but they would be able to influence issues of general principle, such as respect for labour rights or compliance with environmental standards. The network could comprise, as suggested above, around one thousand offices worldwide, each catering to a population of about six million. The network would give a say to local communities who are often ignored by large corporations.

However, the primary duty of the regional and national network would be to organize the cheap and effective disbursement of the global pension to all who qualified for it. In many countries the task could be sub-contracted to the national pension authorities. Where these still had weak coverage assistance might be sought from – and costs shared with – post offices, local micro-credit unions and public sector employees' schemes. The latter exist in many countries where national administration is ineffective or even non-existent. Namibia has developed effective means for delivering the old age pension, employing mobile ATM machines activated by fingerprint ID.

The global pension would be a universal social insurance scheme, not an aid programme. It would channel financial resources directly to the elderly in all communities, whether rich or poor, urban or rural. The costs of administration would, so far as possible, be spent in those communities. Administration costs should amount to no more than 1% of the fund each year, and quite possibly less. It would be a non-means-tested as well as non-contributory 'social pension'. Requiring pension recipients to undergo a means test is demeaning and discourages the poor from saving. It can easily stigmatize the elderly, especially older women.[16]

The global pension would contribute significantly to the 'security in old age' envisaged in Article 25 of the Universal Declaration of Human Rights. UN agencies and conventions have helped to focus global attention on the problems of children, of women, of the sick and disabled. In 2002 the UN sponsored the Second World Assembly on Ageing in Madrid, which issued good advice to member governments. As yet, however, the plight of the aged and the prospect of a surge in their numbers are still not addressed by a specific international agency, nor by a programme with global scope. The global pension would represent a tangible step in the right direction. ■

16 The case for non-means-tested pensions is powerfully advanced in Larry Willmore, "Universal Pensions for Developing Countries", *World Development*, Vol. 35, No. 1, 2001.

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Regulation of hedge funds: Why is it a social security issue?

Originally, hedge funds were supposed to be very specialized investment vehicles whose access was highly restricted to sophisticated investors. But the last few years have seen a considerable broadening of the investor class with access to hedge funds. Governments are also increasingly investing their pension programme money in hedge funds. Since the funds are accessible to common citizens, the need for public intervention to ensure that investments are carried out according to good practices and standards, that managers meet integrity and competence criteria, and that transparency and disclosure requirements are implemented, makes eminent sense.

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Hedge funds can be defined as "private pools of funds that invest in traded instruments (both cash securities and derivatives); can employ leverage through various means, including the use of short positions; and are generally not regulated" (Cole *et al*, 2007, p. 8). Hedge funds specialize in pursuing highly sophisticated, high-risk investment strategies with the purpose of achieving returns above average. In a simpler definition, hedge funds are funds established for the purpose of investing the money of their participating partners (Edwards, 1999, p. 190).

Originally, hedge funds were supposed to be very specialized investment vehicles whose access was highly restricted to sophisticated investors. Direct investment in hedge funds used to be accessible only to wealthy investors, due to high entry tickets (Noyer, 2007, p. 107). Hedge fund investors could be presumed to have the sophistication and the resources to protect their own interests (Crockett, 2007, p. 23; Hildebrand, 2007, p. 71).

But the last few years have seen a considerable broadening of the investor class with access to hedge funds. One way this has happened has been through the relaxation of accreditation requirements, to the point that few if any limits exist on who can invest in hedge funds (Danielson and Zigrand, 2007, p. 31). In many countries, from Hong Kong and Australia to Germany and the UK, a new category of investors with relatively more modest financial means are now able to invest in them. This is also partially the case in France, where hedge funds can now be accessed by individuals with a minimum amount of EUR 10,000 (Prada, 2007, p. 130). Moreover, according to recent news reports, German investors can buy hedge funds from Deutsche Bank in units of less than EUR 125 and UK regulators are considering reducing restrictions on marketing hedge funds to individuals (Financial Times, 2007a).

As part of this movement, regulated institutions accessible to average investors, such as mutual funds and pension funds, are increasing their investments in hedge funds (Danielson and Zigrand, 2007). It is reported that a significant portion of the growth in hedge funds is due to institutional investors' demand for investment alternatives to standard long-only equity and fixed-income investments (Cole *et al*, 2007, p. 11). Hedge funds now tap into a larger share of household savings that is channelled through institutional investors, such as funds of funds[1] and pension funds. In fact, pension funds are estimated to amount to around 30% of the investor base (Noyer, 2007, p. 107; Crockett, 2007, p. 23).[2]

Governments are also increasingly investing their pension programme money in hedge funds. In the United States, for example, the Securities and Exchange Commission (SEC) reports that about 20% of corporate and public pension plans were using hedge funds in 2002, up from 15% in 2001, and the trend is rising.[3] Public pension funds are among a number of entities that have sharply increased the amount of money they put into hedge funds in the last few years, in an effort to boost their returns and diversify their holdings.[4]

Motivation: the crisis of publicly financed social security

A larger pool of retirement savings is being invested in hedge funds through two main channels. The first channel is a direct one: investment by individuals in hedge funds as their choice of instrument to insure themselves. Public institutions in charge of providing retirement support are being either privatized, downsized or precarized. In some cases, public social security systems are providing insufficient assistance, so individuals are advised to rely on their own private insurance systems instead of (or in addition to) those provided by the state. This is especially the case with the generalized switch from defined-benefit to defined-contribution plans. In other cases, the search for private solutions comes from the precarious state of social security programmes and the trend towards a higher ratio of ageing citizens to working citizens, which raises fears about the sustainability of the public system and its ability to respond to the increased demand over the long term.

The second channel is indirect: investment in hedge funds by institutions, whether private or public, that manages individuals' retirement savings. In the case of private institutions, individuals resort to them as a way to complement or replace what are foreseen as meagre pension benefits due to the collapse of public social security systems, and the shift to defined-contribution plans. In the case of the public ones, it is the pressure triggered by the looming difficulties to finance their obligations that is prompting many governments to seek higher-than-average returns through strategies such as those offered by hedge funds.

As can be seen, the collapse of public social security systems is a common thread running through these two channels.

The controversy over the regulation of hedge funds

The reason hedge funds can engage in potentially more rewarding strategies is that they are not regulated. The lack of regulation on hedge funds tended to go relatively undisputed until the end of last decade. The perceived benefits of hedge funds were, in effect, directly linked to their lack of regulation. Hedge funds' higher returns were made possible by the flexibility and capacity to implement innovative strategies that can only happen in the absence of the regulations to which other financial actors, such as mutual funds, are subject. However, as hedge funds have grown in significance and the evidence of their potential shortcomings has begun to come to light, controversy about the need to regulate them has ensued.

Two events at the end of the 1990s became critical hallmarks triggering a reconsideration of the issue of whether hedge funds should be regulated. The first was the East Asian financial crisis. Authorities of the countries affected expressed concern that the activities of hedge funds in their markets during the period of the crisis had a destabilizing impact and could have potentially damaged their economies (Financial Stability Forum, 2000, p. 5). Brouwer (2001, cited by Cornford, 2005) has found grounds for this concern, arguing that operations of macro hedge funds and to a lesser extent financial institutions' proprietary trading desks were an important source of instability in the region's financial markets in 1997-1998 and contributed to the overshooting of exchange rates and other asset prices (Cornford, 2005).

It is worth noting that some researchers, including researchers from the International Monetary Fund (IMF), have called this contention into question (Fox,

1 A fund of funds is an investment fund that holds a portfolio of other investment funds rather than investing directly in shares, bonds or other securities.

2 One of the asserted bases for the retailization of funds is fairness: it is argued that not only wealthy investors should have access to the superior hedge fund returns, which accounts for the fact that sometimes supervisors themselves have called for retailization (rather than the funds themselves).

3 Financial Times (2004a), which also stated that millions of people worldwide, both working and retired, have money invested in hedge funds and might not even know it.

4 *Ibid.*

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1998; IMF 2004, p. 146-8). But Brouwer found that IMF research tends to overemphasize the global size of hedge funds when what matters, he argues, is the size of their positions in relation to those of other actors in particular markets in the region. Leader-follower patterns of behaviour in these markets tend to be neglected in such studies, he says. According to these patterns, groups of hedge funds would act as if in packs and, vis-à-vis other firms, assume the role of leaders based on their willingness to take large positions in particular assets and currencies based on what is widely regarded as superior knowledge (Cornford, 2005).

The second critical landmark was the failure and subsequent bailout of the Long Term Capital Management hedge fund. LTCM had been established in 1994 with equity of USD 1.3 billion and its equity had grown, by 1998, to USD 5 billion (Edwards, 1999, p. 197). For an investor who was in at the beginning and stayed until 1997, the annual return would have been 15% a year (Kahn and Truell, 1998). LTCM's leverage, based on money it had borrowed, was around 20 to 1, high by any standard. A detailed description of the strategy LTCM had pursued and why it failed is beyond the scope of this paper. It is important to note that in September 1998, the Federal Reserve Bank of New York convened a series of firms that had lent money to the company and warned them about the "systemic risk posed by LTCM going into default." Federal Reserve chairman Alan Greenspan asserted that rescuing LTCM was necessary to prevent markets from "seizing up" and "impairing the economies of many nations." As a result, a consortium of financial institutions organized a rescue (Edwards, 1999).

By 1999 the (then) Group of 7 (G7) had decided to task the Financial Stability Forum with calling a Working Group on Highly Leveraged Institutions. The Working Group was set up with a mandate to "assess the challenges posed by highly leveraged institutions to financial stability and to achieve consensus on the supervisory and regulatory actions which would minimize their destabilizing potential" (Financial Stability Forum, 2000, p. 1).

The Working Group took the approach that the challenges were best addressed through indirect regulation measures, such as better risk management practices in counterparty institutions and the bolstering of market discipline through enhanced disclosure requirements.[5]

In 2006, the regulation of hedge funds drew renewed attention. Some events that contributed to this were the USD 6 billion loss by hedge fund Amaranth and the 75% loss of its USD 13 billion fixed income trading by hedge fund Vega. The government of Germany, which had already taken some strong positions on the subject, and whose public exhibits a pronounced hostility towards hedge funds, announced in late 2006 that it intended to use its presidency of the G8 (in 2007) to place hedge funds on the Group's agenda (Financial Times, 2007c; 2007d; 2007e). In February 2007, at their first meeting of the year, the G7 Finance Ministers agreed on commissioning the Financial Stability Forum to update its 2000 report on hedge fund practices, and calling for direct talks with the hedge fund industry about future regulatory options.[6]

However, the G8 Summit at Heiligendamm (June 2007) failed to take any meaningful action. The German finance minister's attempts to push for an agreement on tightening regulation of hedge funds were quickly opposed, mainly by the US and UK governments, and were soon watered down to mere calls for disclosure in the interest of greater transparency. As the G8 Summit drew closer, it seemed that even modest transparency requirements of a mandatory nature were too much to enforce on hedge funds. The German government had toned down its demand to have a Code of Conduct, with the US arguing that if such a Code of Conduct was necessary the hedge fund industry itself would be advocating the idea and designing it, so not much action was required on the part of governments. In the end, the G8 communiqué settled for taking note of an updated report on the matter prepared by the Financial Stability Forum, and promised further work.

Circumventing safeguards meant to protect citizens' futures

The main rationale behind regulation of mutual funds and pension funds has been the need to protect the interest of the citizens who invest in them. Since the funds are accessible to common citizens who presumably have little or no investment expertise, the need for public intervention to ensure that investments are carried out according to good practices and standards, that managers meet integrity and competence criteria, and that transparency and disclosure requirements are implemented, makes eminent sense.

Since hedge funds were originally limited to 'high net worth' or wealthy investors, that rationale was arguably not applicable to them. In fact, hedge funds were largely created to limit the constraints that regulation set on other financial institutions for this very limited group of superwealthy investors, who were very much 'insiders' to the world of investment strategies and could be trusted to know what they were doing.

As mentioned above, restricted investors' access is no longer a characteristic of hedge funds. Thus, the more that hedge funds are similar to other investment vehicles accessible to common citizens, the weaker the rationale for keeping them outside of regulatory scrutiny. Moreover, we argue that when the funds that could be at risk are the retirement savings of ordinary people, the issue becomes one of social security regulation. In fact, the state jeopardizes its social security obligations when it invests in hedge funds and when it fails to properly regulate them. If citizens have to rely on private pension systems, and the state is unwilling to regulate the investments made by these agents in hedge funds, or the behaviour of hedge funds that actually receive pension savings, then the state is relinquishing its obligations to regulate in the interest of the social security of its citizens.

The risk to retirement savings

The better returns achieved by hedge funds come at the cost of higher risk. In hedge funds, this higher risk results from the use of leverage, oftentimes several layers of it. In this regard, for example, investors could borrow to invest in funds of funds which, in turn, borrow to invest in hedge funds which, in turn, use derivatives to leverage themselves (Ferguson and Laster, 2007, p. 53). Hedge funds can leverage themselves with very high multiples either directly (borrowing from prime brokers)[7] and indirectly (through selling credit derivatives), making themselves especially vulnerable to a sudden decrease in market liquidity (Noyer, 2007, p. 108).

Moreover, there is a generalized view that hedge funds' leverage, in the aggregate, only keeps increasing. A figure from 2004 indicated hedge fund leverage in the form of bank debt to be at an average of 141% (Financial Times, 2004b). Leaving estimates aside, though, the main problem is posed by the lack of reporting requirements on hedge funds, which makes it very difficult to know, at any point in time, how leveraged hedge funds really are, especially through their derivatives exposure. An expert witness who testified to the US Congress when it inquired into the crisis at LTCM is quoted as saying: "When Greenspan went round the banks and asked them what the impact would be on their balance sheets of allowing the fund to go down, they said they didn't really know, and didn't want to find out" (Financial Times, 2004b).

According to one author, effective leverage "has become notoriously difficult to measure, due to the difficulty in capturing the effect of different layers of leverage, and in particular the leverage embedded in the most complex forms of credit derivatives." (Noyer, 2007, p. 109). According to the vice president of the European Central Bank, "the total leveraged assets of an individual hedge fund can sometimes be quite significant and comparable with the size of some systemically important banks" (Papademos, 2007, p. 115).

Not only do hedge funds present higher risks but, as repeatedly warned by analysts, the benign liquidity conditions prevailing in the market in which they have proliferated makes current hedge fund-related risks hard to even estimate with any degree of accuracy.

Ethical issues regarding the types of investment made by hedge funds

In addition to the issues raised for the average citizens whose savings end up feeding hedge funds, it is important to assess the ethical issues raised by the behaviour in which hedge funds engage when utilizing those savings. In their search for financial performance, hedge funds have been known to incur in strategies with negative impacts on the 'real economy' and workers.

5 It is worth noting that, according to a recent assessment by the European Central Bank, the implementation of even the limited measures called for in this report remains far from satisfactory (European Central Bank, 2005).

6 *Ibid*. The political currency of regulating hedge funds is not unique to the German context. For instance, US Senator Charles Grassley (Chair of the Senate Finance Committee in 2007) sent a letter in October 2006 to all US financial regulators seeking information about reporting requirements, if any, of hedge funds. During his campaign, Nicolas Sarkozy – who would later be elected in the French presidential elections – promised to take a tough stance on hedge fund regulation.

7 A broker which acts as settlement agent, provides custody for assets, provides financing for leverage, and prepares daily account statements for its clients, who are money managers, hedge funds, market makers, arbitrageurs, specialists and other professional investors.

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There is certainly no question that the real economy suffers most when financial crises of a systemic nature are triggered by the speculative activities of hedge funds, as many argue was the case in the East Asian crisis. But even without such large-scale events, routine activities pursued by hedge funds pose threats that cannot be ignored.

As US House of Representatives Financial Services Committee chairman Barney Frank stated in a letter addressed to President Bush in May 2007:

> An important question to explore is whether the high rates of return required to finance private equity debt-driven buy-outs can jeopardize the long-term interests of target companies and the provision of decent employment conditions and employee security. We are troubled by those cases in which rather than corporate restructuring for the purpose of shared productivity gains and increased competitiveness, numerous private equity funds now appear to be looking at extracting maximum value over a short period before re-selling the company. This poses the risk that employees will be disadvantaged in a fashion that would not have happened without the acquisition.

One example of these hedge fund practices consists of influencing the direction of companies by taking activist positions in their shareholder assemblies. While it is common to assume that this activism brings more efficiency to corporations by creating value and promoting efficiency, it can also disrupt companies' economic activity based on immediate return considerations, and regardless of other implications for the long-term performance of the company. Critics of funds have argued that they are interested only in short-term returns, which may be generated at the expense of the long-term interest of the companies in whose securities they invest (Crockett, 2007, p. 24).

Notably, this criticism was recently voiced by German Finance Minister Peer Steinbrück, who said that "the German model – medium to long-term industrial planning – worked even if it was not compatible with the short-term aims of hedge funds." He went on to add: "The focus of industry should be 'how do I keep a company market-competitive in the medium term' – not the short-term profit maximization" (Financial Times, 2007g).

Similar concerns were expressed by SEC commissioner Paul Atkins, who warned that "giving investors greater say on the composition of boards could have the unintended consequence of increasing the power of hedge funds… What if a shareholder who participates by voting at a meeting holds no economic interest or possibly a negative interest in the corporation?" (Financial Times, 2007b). Meanwhile, two University of Texas professors warned in a 2006 study that hedge fund tactics could be eroding the traditional link between economic ownership of shares and corporate voting power (Financial Times, 2007b).

However, 'short-termism' is also especially damaging to employees in the restructured companies who, as stated by Paul Myners, the former chairman of Marks and Spencer, "generally suffer an erosion of job security and a loss of benefits" (Financial Times, 2007f). It is worth noting that leveraged buy-outs of the type practiced by hedge funds with profit-making purposes are financed with debt, with the purchased firm becoming responsible for servicing those debts. The higher the leverage, the higher the risk of subsequent failure of the company, with workers being the first casualty.

Moreover, workers may be double losers in this trend because, at the same time, the high profits are made possible by the fact that interest can be offset against tax in many jurisdictions, which basically means taxpayers' money is what subsidizes the profits. Lower tax pressure on the owners of big capital means, everything else being equal, more tax pressure on workers.

'Short-termism' might be especially damaging to long-term economic considerations in the context of the increased hedge fund shareholder activism aimed at forcing specific management decisions (or management changes) through their stakes in a company. This risk exists when funds take short-term stakes, using non-transparent techniques, with the sole objective of putting pressure on management, at a specific point in time, for the defence of their specific interests (Prada, 2007, p. 133).

Recently, analysts have noted another channel through which hedge funds may influence the real economy, that is, in the context of increased difficulties for companies to achieve workouts. Bankruptcy regimes are a policy instrument that countries craft with the goal of setting incentives for companies' productive activities not to be unduly disrupted. They balance the interests of creditors and debtors on the basis of protecting the longer-term interest of society in not disrupting production processes vital to the economy. Hedge fund intervention may dramatically distort these incentives, as noted by an analyst: "In the past, banks that held loans on their balance sheets had a substantial financial incentive to come to an amicable workout with borrowers. When banks securitize loans, however, that incentive may be diminished because they don't bear as much of the risk of default… [H]edge funds and even banks may profit from a default if they have bought protection through a credit default swap in excess of the amount of the loans they hold… [Hedge funds'] participation can also affect the ability of borrowers near default to work out their problems" (Cole *et al*, 2007, p. 10).

The implications of this problem have come to light recently in the US in the context of the crisis of subprime mortgage lending and the intervention by banks and regulators to aid subprime borrowers facing steep interest rates on their housing loans. What would have otherwise been a reasonable and welcome help to disadvantaged communities of borrowers, became the target of accusations by hedge funds holding derivatives tied to defaults on such loans, who had bet that defaults would take place.

Conclusion

The crisis in state-provided pension benefits has meant that an increasing share of citizens' retirement savings is being placed in hedge funds. The original rationale for not regulating hedge funds (their availability only to a limited number of investors) is no longer in place. Stronger regulation of hedge funds in the interest of fulfilling social security obligations is long overdue. Otherwise, hedge funds will have simply become vehicles by which social security obligations can be easily circumvented. ■

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Pension fund investment in private equity funds

Pensions are not like other classes of financial investment, where investors select part of their surplus income to make a bet. Pensions are meant to guarantee a minimum income level that allows the retiree to maintain a certain quality of life. The investors in pension funds are the middle classes and, in the more developed countries, the workers, and their future incomes should not be the result of the kind of market games played by private equity funds or hedge funds.

Fernando J. Cardim de Carvalho[1]

The rise of the pension fund industry

Most social security systems suffered deeply with the fall in rates of economic growth that followed the so-called golden era of capitalism from the end of the Second World War until the late 1960s. Even in countries where the benefits offered by official retirement schemes were not particularly generous, as in the United States, social security ran into trouble when employment growth decelerated in the 1970s and afterwards. In many cases these systems had become Ponzi schemes, where benefits were paid not with the yield of past investments but with the revenues generated by new entrants.

While economies were growing rapidly and employment was expanding, new members' contributions were more than enough to pay benefits. With the end of the post-war Keynesian era and the rolling back of state economic initiatives that characterized the Reagan/Thatcher neoliberal counterrevolution, rates of growth fell and new revenues have become less and less sufficient to keep the system running.

In parallel with the accumulation of financial imbalances in social security schemes, social security systems also became the target of growing ideological criticism, which frequently pointed to the 'perverse incentives' these systems were allegedly creating. Even now conservative and neoliberal critics of social security nets insistently claim that these schemes encourage workers to remain idle, since they can earn enough to survive without having to work.

The wide and relentless attack on social security schemes, and the repeated 'reforms' to which they were submitted, made clear to most workers that they had to begin providing for their own retirement or at least to look for means to add to their expected incomes in the future when they retired.

Of course, only Chile under the Pinochet dictatorship went as far as practically eliminating official schemes and replacing them with entirely private schemes. Presented as an important 'innovation' by the financial community and those who share its views, the Chilean model could not escape criticism, however, even from publications dedicated to that very community. Thus, *Institutional Investor* magazine, for instance, could not avoid acknowledging that "the goodwill that the A[dministradoras de] F[ondos de] P[ension] reaped for their role in Chile's economic success diverted attention from some glaring flaws in the privatized pension fund system." Quoting a local authority, the magazine concludes its analysis stating that "no matter how instrumental the AFPs have been to Chile's economic development, 'they seem to have forgotten about their social welfare role, which is the main reason they were created.'"[2]

In fact, the alleged social welfare role of private pension funds – namely, to provide for retirement income levels that the official schemes were no longer capable of offering – were never the real priority, especially in the case of developing countries. The reforms that created private pension funds, or enlarged their role where they already existed, approached them mostly as promising vehicles to increase household savings and to channel them to public and private securities markets. This, again, was clearly the case of Pinochet's Chile but is also characteristic of other developing countries' experiences.

In this sense, pension funds quickly became just another class of investment funds. Their special nature, which is to provide a basic level of income in the future, was residually acknowledged in some regulatory provisions, limiting their exposure to certain riskier classes of investment. These limitations, however, have become less and less effective since financial institutions have been able to circumvent them with relative ease.

Thus, pension funds ended up being just another category of collective investment schemes, which are designed as institutional investors, meaning that it is another form of gathering investors so as to create a formal *institution*. They are managed by professional fund managers, usually trained in ordinary financial institutions, and their performance is measured by criteria that are not much different from those applied to other investment funds. Many times, in fact, management of these funds is performed by employees of large financial conglomerates, through asset management divisions.

In this scenario, the *social* role of pension funds is only remembered when a crisis hits a particular group, destroying the assets of the respective pension fund, as was the case with Enron. When this happens, one hears demands for regulation and supervision, but these tend to quickly fade away, drowned out by the counterclaims of the financial markets and their spokespeople who strive to keep the system as it is.

The shift to riskier investments

Since the early 1990s a number of important forces have combined to push pension funds even farther away from their social role toward behaving like an ordinary institutional investor. On the one hand, liquidity has been very high in national and international financial markets, lowering interest rates and the returns on financial investments. In addition, a relatively long cycle of economic expansion began in the late 1980s, which still persists. In the last almost 20 years, growth periods have prevailed and recessions have been relatively light and short-lived (with the obvious exception of countries hit by capital flight crises, as in the case of the Asian crises of 1997-1998, the Russian crisis of 1998 or the Argentine crisis of 2002). Non-performing loans have been kept at low levels so that attenuated risk factors have also contributed to the reduction of interest rates in the main financial markets of the world.

Under these conditions, practically every institutional investor, including pension funds, began searching for alternative investments that could offer higher returns. These higher returns could be found, naturally, in riskier investments, such as high-yield bonds (formerly known as 'junk bonds', a definitely less attractive denomination), or emerging country securities. To participate in these markets, institutional investors usually invest in hedge funds[3] or in private equity funds.

Since fund managers' performance is usually evaluated relative to the average performance of their class, there is a strong tendency for a kind of herd behaviour to emerge. Thus, once some funds begin participating in riskier markets and do enjoy higher earnings as a result, the managers of other funds have little choice but to follow the leaders, to try to emulate their earnings. Once a sufficiently large number of pension funds have taken this path, following it becomes conventional wisdom for the remaining fund managers.

What is a private equity fund?

Private equity (PE) funds are partnerships between investors, called limited partners, and fund managers, called general partners, specializing

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2 "Chile: The Empire Strikes Back", *Institutional Investor*, April 2007, p. 96, 99.

3 For more information on hedge funds, see the article by Aldo Caliari in this Report.

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in venture capital investments or in buyout investments (Phalippou and Zollo, 2005). They are not new actors in financial markets, but their importance has increased dramatically in recent years. *The Economist* recently quoted a research group's estimate that PE funds raised USD 240 billion in the first six months of 2007 alone.[4] Researchers from the University of Pennsylvania's Wharton School estimate that PE funds manage approximately USD 1 trillion of capital.

PE funds, like hedge funds, boost their returns by heavily leveraging their capital. This means that these funds invest much more than their own capital. In fact, their own capital is used mostly to obtain loans that allow them to buy assets that will in turn be used as collateral to obtain still more loans, and so on and so on.

According to one source, two thirds of those trillion dollars under the control of PE funds are managed by buyout funds. These funds buy public companies – that is, corporations whose stock is traded on stock exchanges; turn them 'private' – that is, take them out of public view; and restructure them with a view to increasing their market value in order to resell them at a profit.

'Restructuring' in this context may mean a lot of things. PE fund apologists argue that the value of a company is increased by cutting unnecessary expenses, streamlining the company by getting rid of less productive divisions, introducing better management methods, and more efficiently aligning the interests of managers and shareholders. If this is true, companies emerge fitter and more efficient from this process, and it is the ability to engage in this restructuring that generates the profits made by the funds.

Critics of PE funds, on the other hand, point out that the value of acquired companies tends to increase mostly because of debt piling up.[5] Firms managed by PE funds borrow heavily to increase their return on equity (ROE), at the cost, of course, of making them much more vulnerable to adverse changes in financial markets. Since the early 1990s, as already observed, it has been easy to borrow at low interest rates, making the PE funds' strategy easier.

However, when this excess market liquidity begins to dry up, as it necessarily will at some point, and interest rates begin to rise, heavily indebted firms may suffer dramatic losses. Under these conditions, as observed by *The Economist*: "A bigger role for private equity might make the economy more vulnerable. Historically, recessions have often occurred when rising interest rates have cut into corporate profits, causing firms to slash employment and capital expenditure. In a world where most companies carried private-equity-style debt levels, companies would be much more vulnerable and recessions might become much more frequent."[6]

4 "The business of making money", *The Economist*, 7 July 2007.

5 "Private Illusions", *Institutional Investor*, January 2007, p. 99/100.

6 *The Economist*, *op. cit.*, p. 70.

Nevertheless, as long as interest rates remain low, stock exchanges remain active, and stock prices continue rising, PE investments are likely to remain very attractive. As has been amply noted by analysts of financial market behaviour, rising asset prices tend to blind market participants to risks, and the lure of profit opportunities is too strong to resist in the absence of regulatory limits.

In fact, even if a disaster like a full-scale financial crisis does not actually take place, the legacy of PE funds is an increase of debt that is likely to reduce the ability of firms to make productive investments. The increased risk of default attached to highly indebted firms increases the cost of capital and raises the minimum required profitability of capital to allow new investments. It may take a long time for these firms to rebalance their capital structure to allow them to operate normally again.

The relative importance of PE funds as a source of finance is still relatively small but growing fast. Moreover, these funds are extending their reach even to markets that used to be considered protected against their influence, such as the financial markets themselves. They are also expanding into the real estate business.[7]

PE funds are usually favoured by the lighter tax treatment of capital gains as compared to income earnings, which most countries tended to adopt after the Reagan/Thatcher counterrevolution. They are also favoured by the so far long-lasting context of an excess supply of loans, which has allowed what is currently known as a 'covenant-lite' loan structure. This means that lenders are so numerous at this point that they do not feel they can impose conditions on the use of their loans, giving much more freedom to borrowers like PE fund managers.[8]

Of course, there may very well be an element of truth in the arguments of both supporters and critics of PE funds. Their benefits may be more visible in the case of venture capital, where the funds help to finance nascent firms, than in the case of buyout funds, where restructuring may very well be, as *Institutional Investor* suggested, merely "sleight of hand," a trick allowing fund managers to increase the appearance of profitability of companies to sell them back in public markets. In fact, the jury is still out on the PE strategy as such, although it is increasingly clear to almost anybody that the tax incentive represented by the favourable treatment of capital gains should be eliminated and that regulation should be beefed up in this market segment.[9]

7 "Private Property", *Institutional Investor*, December 2006.

8 "Taking a Plunge on Univision", *Institutional Investor*, April 2007.

9 In fact, PE funds themselves may be bracing up to face at least some of these changes. A recent document issued by the British financial regulator, FSA, noted that "the industry has asked Sir David Walker to chair a high-level working group to assess the adequacy of disclosure arrangements and the clarity and consistency of valuations and returns employed by UK private equity firms. *The intention is to establish a voluntary code of compliance in these areas.*" (FSA, 2007, p. 4, emphasis by the author). PE funds seem to be trying to preempt more hostile forms of *official* regulation by offering to restrain their own behavior through *self-regulation*.

Risks and benefits for pension funds

If the macroeconomic or social benefits of the operation of PE funds may still be difficult to ascertain, there may also be less than meets the eye when this investment alternative is investigated more closely. As in the case of hedge funds, there is a widespread view that there should be no attempt to curb these types of investment, because they are so profitable that market actors would always find a way to circumvent the barriers. If PE investments are really that profitable, preventing pension funds from enjoying the promised high returns, even if at the cost of some degree of risk exposure, could be unjustifiable or simply unenforceable.

There are several important reasons to question this assumption, however. A number of studies of the performance of private equity funds have shown that the exceedingly high returns exhibited by them in recent years may not be the whole story.

It is usually accepted that PE funds have reached yearly returns on equity of around 25%, which is, certainly, a very high figure. However, before accepting this number as a true reflection of the performance of the PE sector, some qualifications have to be made. We will focus on four of them.

The first qualification is actually very important, given the generally accepted view that this is a particularly risky industry. When analyzing industry returns, one has to adjust the available information for what is called the 'survivor's bias'. The concept is quite simple. Let us assume that two PE funds invest USD 100 each. The first succeeds and earns USD 200. The second goes under and loses its capital. When an industry survey is taken, the second fund is no longer there to respond to the questions. So what the survey is going to show is only the result of the first firm, with a 100% rate of return. In risky industries, the rate of mortality tends to be higher than average. Results therefore tend to heavily exaggerate the profitability of PE funds because only the successful survivors are actually surveyed.

A second qualification is that after a PE fund buys out a firm and makes it 'private', the value of the assets bought by the fund is difficult to ascertain. The fund may record how much it paid for the equity but there is no guarantee that it is actually worth what was paid. Some PE funds simply become inactive as an alternative to reselling equities with a loss. So when surveys measure the assets of PE funds they tend to count potentially worthless assets as still worth their original price.

A third qualification refers to risk. All financial investments offer combinations of return and risk. The higher the risk, the higher the rate of return must be to induce the investor to buy that particular asset. Accounting measures of profitability are not adjusted for risk, which is especially serious in the case of riskier investments such as PE funds.

Finally, the return to the PE fund is not the same thing as the return to the investor, because fund managers tend to charge very heavy fees from the investors. In fact, the standard structure includes a fixed fee as a percentage of the capital of the fund, a large share of the gains (usually 20% of the

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profits, called 'carried interest'), as well as other fees of lesser impact.

In the light of all these factors, it is not very surprising to find that PE fund managers, or general partners, are doing very well, while the investors, or limited partners, are not. Phalippou and Zollo (2005) showed that, all things considered, investors in PE funds may have earned less than they would have if they had simply bought the Standard and Poor's 500 stock basket. In other words, they earned less than the market average. A. Metrick and A. Yasuda, on the other hand, showed in an unpublished 2007 study that fund managers did very well, with buyout managers benefiting more so than venture capital managers.

Conclusion

Whatever the final word on the cost/benefit ratio of the operation of PE funds for the economy as a whole may be, the benefits of these investments for pension funds can already be judged as very doubtful, at best. In fact, risk itself should be a decisive factor to prevent pension funds from participating in these markets. Pensions are not like other classes of financial investment, where investors select part of their surplus income to make a bet. Pensions are meant to guarantee a minimum income level that allows the retiree to maintain a certain quality of life. Wealthy investors do not invest in pension funds because they usually have access to other, more profitable, opportunities. The investors in pension funds are the middle classes and, in the more developed countries, the workers, and their future incomes should not be the result of the kind of market games played by PE funds or hedge funds.

This concern is strengthened by evidence of the possibility that workers' money is simply being squandered by these funds, since their performance, when adjusted in the way suggested in the preceding section, is below par – although this does not prevent the managers of these funds from taking a large bite of whatever returns are achieved.

Stricter regulation of the investments that pension funds are allowed to make is, of course, a second-best solution. The truly appropriate solution would be, above all, to restore the primacy of full employment as a social goal, as it was in the first two decades after the end of the Second World War, since this would obviate many of the financial problems of social security systems. There is also a need to promote a broad debate with all sectors of society as to the perspectives of the social security system, in order to make it socially fair and economically sustainable. Unfortunately, the political climate is still unfavourable to such a debate, since neoliberal ideas about the virtues of the market are still strong, particularly among influential political groups. In such a situation, a second-best solution preventing pension funds from trading workers' futures for illusory short-term gains should be explored. ■

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GLOBAL TAXES FOR GLOBAL WELFARE

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For many of the problems and challenges currently facing the international community, it is impossible for individual nations to find and apply proper solutions on their own. These challenges include global warming, the spread of global diseases, financial instability, pollution and loss of biodiversity, among many others.

At the same time, governments are facing a crisis in tax income, for a variety of reasons: recent globalization processes, new financial mechanisms, the widespread use of tax havens and corporate practices such as the abuse of transfer pricing, tax avoidance and tax evasion.

This situation has made it increasingly difficult for governments in both the South and the North to ensure fiscal justice and finance social security for their citizens. As a result, the need for innovative mechanisms to finance global welfare, enhance international cooperation and safeguard global public goods has become one of the most urgent priorities facing the planet.

From another point of view, there is a need to find adequate ways to regulate and counteract the most negative impacts of globalization, and to apply democratic and effective instruments to ensure political control over economics, trade and financial powers, which implies a profound reform of current governance mechanisms and institutions.

International taxes appear to be the best instrument to implement in the medium term to fulfil these different goals: finding new ways to finance social security and global public goods; regulating some of the negative impacts of globalization; reinforcing international cooperation among different countries; and reforming international governance.

While the primary goal of national taxes is to generate revenues, in the case of global taxation systems, the most important positive impact could be their regulation effect on some of the most adverse impacts of recent economic trends. A Tobin tax on international financial transactions, for instance, would contribute to combating financial instability, while a carbon tax would target the most polluting activities and foster the development and use of cleaner, more sustainable energy sources.

Moreover, global taxes could raise enough money to fulfil the Millennium Development Goals (MDGs) or to help finance and preserve global social security, fundamental human rights and global public goods.

The technical problems involved in the implementation of these global taxes have been resolved. In many cases, the biggest obstacle to their application is the lobbying power of the small elite that would be hit by these instruments. It is now only a matter of political will: politicians must have the intelligence and courage to move forward and implement these instruments, which would benefit the vast majority of women and men in both the North and the South. ■

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Tax havens and corruption: A global struggle

A minimum of USD 1 trillion of dirty money flows annually into offshore accounts, approximately half of which originates from developing countries. Despite the plethora of anti-money laundering initiatives, the failure rate for detecting dirty money flows is astonishingly high. Tax dodging corrupts the revenue systems of the modern state and undermines the ability of the state to provide the services required by its citizens. It therefore represents the highest form of corruption because it directly deprives society of legitimate public resources; this is the reason why international tax abuse has to become the next big front in the battles over international development, corruption, inequality, and globalization.

John Christensen
Tax Justice Network International Secretariat[1]

The parallel economy

The stage is being prepared for one of the epic struggles of our times. Secretly and audaciously, over the past half century, professional elites and their powerful clients have constructed a parallel global economy – often referred to as tax havens – to remove themselves from 'onshore' taxes and regulation. This parallel economy provides an enabling infrastructure of banks, legal and accounting businesses, minor legislatures and judiciaries, and related financial intermediaries, which combine to serve as an 'offshore interface' between the illicit and the licit economies.[2] This interface has encouraged and facilitated capital flight from poor countries to rich ones on a truly awesome scale. It has enabled tax dodging, shifting the tax burden from capital to labour and significantly contributing to widening inequality. It has undermined the integrity of tax systems and respect for the rule of law.

Democracy itself is undermined by covert deals and special treatments. The offshore interface has distorted global markets to the disadvantage of innovation and entrepreneurship, and slowed economic growth by rewarding free-riding and misdirecting investment. It is identified as a major causal factor behind the growth of high-level corruption. It functions through collusion between private sector financial intermediaries and the governments of states which host offshore tax haven activities. The forthcoming struggle requires a radical rethink of the nature and geography of corruption, forcing civil society to tackle major flaws in the global financial architecture and overcome the political power of major vested interests.

International tax abuse must become the next big front in the battles over international development, corruption, inequality and globalization. Partly because of the complexity of these issues, civil society organizations have mostly shied away from some of the most important aspects of these debates, leaving these fields to be colonized by highly paid experts beholden to powerful and wealthy interests. The time has come for civil society to step up and take them on.

Contrary to the evocative images conjured up by the term 'offshore', it would be wrong to think of offshore as disconnected and remote from mainstream nation states. Geographically, many of the offshore tax havens are located on small island economies dispersed across the spectrum of time zones (see Table 1), but politically and economically the majority of tax havens are intimately tied to major Organisation for Economic Cooperation and Development (OECD) states, and the term 'offshore' is strictly a political statement about the relationship between the state and parts of its related territories.[3]

In the case of Britain, for example, the bulk of offshore transactions are controlled by the City of London, even though many City financial intermediaries operate from offices located in UK overseas territories and crown dependencies. These jurisdictions project the impression that they operate autonomously, but in practice they largely act as booking centres for instructions issuing out of the City of London and other major finance centres. They are primarily of use to the City because they offer zero or minimal tax rates combined with secrecy arrangements (including non-disclosure of beneficial ownership of companies and trusts) and regulatory regimes which are more permissive than those prevailing onshore. Many tax havens are directly linked to Britain, either through overseas territory or crown dependency status, or through membership in the Commonwealth. When asked at the conclusion of her enquiries into the Elf scandal which engulfed the French oil giant in the 1990s whether corruption on a similar scale could occur in the United Kingdom, the Norwegian anti-corruption campaigner Eva Joly commented that many of the world's biggest tax havens, most notably the City of London itself, are under British control, adding: "The United Kingdom has maintained its privileges by allowing British companies to operate from their own tax havens. The expansion in the use of these jurisdictions has a link to decolonization. It is a modern form of colonialism."

Joly refers to tax havens as the principal target in the emerging phase of the anti-corruption debate, arguing: "There is nothing more important for those who want to tackle poverty in the world than to make it possible to trace dirty money flows and impose sanctions on those territories which don't cooperate with this process."[4]

Offshore secrecy, either created through banking secrecy laws or through de facto judicial arrangements and banking practices, is a major barrier to tracing dirty money flows and tackling corrupt activities. This 'secrecy space' creates an effective barrier to investigation of activities in the offshore financial centre by external authorities,[5] and facilitates the laundering of proceeds from a wide range of criminal and corrupt activities, including fraud, embezzlement and theft, bribery, drug trafficking, illegal arms trafficking, counterfeiting, insider trading, false trade invoicing, transfer mispricing, and tax dodging. Elaborate schemes are devised to 'weave' dirty money into commercial transactions and to disguise the proceeds of crime and tax evasion using complex offshore structures. According to one expert investigator:

> Methods to launder money vary dramatically from low-level, relatively simple to highly structured and complex business scenarios or transfer of money offshore. What is being increasingly identified is the infiltration of criminal identities into otherwise legitimate business interests. None of these people could get away with a lot of what they were doing if it wasn't for lawyers, accountants, financial advisers, and the like, knowingly assisting them to launder and hide assets.[6]

A minimum of USD 1 trillion of dirty money[7] flows annually into offshore accounts, approximately half of which originates from developing countries.[8]

1 <www.taxjustice.net>

2 For a detailed analysis of the origins of tax havens and their linkages with the global economy see: Hampton, M. (1996). *The Offshore Interface: Tax Havens in the Global Economy.* Basingstoke: MacMillan.

3 Palan, R. (1999). "Offshore and the Structural Enablement of Sovereignty", in Hampton, M.P. and Abbott, J.P. (eds). *Offshore Finance Centres and Tax Havens: The Rise of Global Capital.* Basingstoke: MacMillan.

4 Quoted from "Pour Eva Joly: Le G8 ne lutte pas vraiment contre la corruption". Interview in *La Tribune*, 6 June 2007.

5 Christensen, J. and Hampton, M.P. (1999). "A Legislature for Hire: The Capture of the State in Jersey's Offshore Finance Centre", in Hampton, M.P. and Abbott, J.P, *op cit.*

6 Detective Superintendent Des Bray, of the Commercial and Electronic Crime Branch, interviewed in the *Adelaide Advertiser*, "Lawyers helping to launder money", 4 June 2007. Available from: <www.theadvertiser.news.com.au/?from=ni_story>.

7 Dirty money is defined as money that is obtained, transferred or used illegally.

8 Baker, R. (2005). *Capitalism's Achilles Heel.* Hoboken, New Jersey: John Wiley & Sons.

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Despite the plethora of anti-money laundering initiatives, the failure rate for detecting dirty money flows is astonishingly high. According to a Swiss banker, only 0.01% of dirty money flowing through Switzerland is detected.[9] It is unlikely that other offshore finance centres are any better. Crucially the techniques used for tax dodging and laundering dirty money involve identical mechanisms and financial subterfuges: tax havens, offshore companies and trusts, foundations, correspondent banks, nominee directors, dummy wire transfers, etc.

Legal institutions granted special status and privilege by society have been subverted to purposes for which they were never intended. For example, the original purpose of trusts was to promote the protection of spouses and other family members who are unable to look after their own affairs, and to promote charitable causes. Incredible as it must appear to those not familiar with the offshore economy, charitable trusts are regularly set up in offshore tax havens for the purposes of owning 'special purpose vehicles' used for international tax planning and for hiding both assets and liabilities offshore, as happened with Enron and Parmalat.[10]

The remarkable growth of the offshore economy since the mid-1970s reveals a major fault line in the financial liberalization process. Whilst capital has become almost totally mobile, the systems for tracking cross-border dirty money flows remain largely nationally based. The unsurprising outcome has been a massive increase in cross-border dirty money flows, often taking the form of falsified trade invoicing and transfer mispricing between subsidiaries of multinational companies. The vast majority of these funds are laundered via complex offshore ladders operating through the global banking system. Huge sums are involved, particularly for developing countries prone to capital flight. Estimates of capital flight from Africa vary considerably, but according to the African Union USD 148 billion leaves the continent every year through dirty money flows.[11]

Most analysts agree that the outflows of dirty money originating from Africa tend to be permanent, indicating that between 80% and 90% of such flows remain outside the continent.[12] Another study concludes that Sub-Saharan Africa is a net creditor to the rest of the world in the sense that external assets (i.e. the stock of flight capital) exceed external liabilities

TABLE 1. Tax havens of the world

The Caribbean and Americas	Europe	Africa
Anguilla	Alderney*	Liberia
Antigua and Barbuda*	Andorra	Mauritius
Aruba*	Belgium*	Melilla*
The Bahamas	Campione d'Italia*	The Seychelles*
Barbados	City of London	São Tomé e Príncipe*
Belize	Cyprus	Somalia*
Bermuda	Frankfurt	South Africa*
British Virgin Islands	Gibraltar	**Middle East and Asia**
Cayman Islands	Guernsey	Bahrain
Costa Rica	Hungary*	Dubai*
Dominica*	Iceland*	Hong Kong
Grenada	Ireland (Dublin)*	Labuan
Montserrat*	Ingushetia*	Lebanon
Netherland Antilles	Isle of Man	Macau*
New York	Jersey	Singapore
Panama	Liechtenstein	Tel Aviv*
Saint Lucia*	Luxembourg	Taipei*
St. Kitts & Nevis*	Madeira*	**Indian and Pacific Oceans**
Saint Vincent and the Grenadines*	Malta*	The Cook Islands
Turks and Caicos Islands	Monaco	The Maldives*
Uruguay*	Netherlands	The Marianas
US Virgin Islands*	Sark	Marshall Islands
	Switzerland	Samoa*
	Trieste*	Tonga*
	Turkish Republic of Northern Cyprus*	Vanuatu

Note: This list excludes territories with some tax haven features but which are not commonly used as such. Territories marked with an asterisk (*) have developed their activities in the last 25 years, representing almost a doubling in the number of tax haven territories during that period.

Source: *Tax us if you can*, Tax Justice Network, 2005.

(i.e. external debt).[13] The problem is that the assets are largely held in private hands, whilst the liabilities belong to the African public.

Rethinking the nature and geography of corruption

Tax dodging corrupts the revenue systems of the modern state and undermines the ability of the state to provide the services required by its citizens. It therefore represents the highest form of corruption because it directly deprives society of legitimate public resources. Tax dodgers include institutions and individuals who enjoy privileged social positions but see themselves as an elite detached from normal society and reject "any of the obligations that citizenship in a normal polity implies."[14] This group comprises wealthy individuals and high income earners, plus a 'pinstripe infrastructure' of professional bankers, lawyers, and accountants, with an accompanying offshore infrastructure of tax havens with quasi-independent polities, judiciaries and regulatory authorities. This type of corruption therefore involves collusion between private and public sector actors, who exploit privileged status to undermine national tax regimes.

The failure to tackle these major flaws in the globalized financial system has generated a spirit of lawlessness and corruption which acts as a cancer on our trust in the integrity of the market system and democracy. Tax dodging by rich individuals forces governments to switch the tax burden to the less well-off, increasing inequality and harming development prospects by reducing the revenues available for investment in education and infrastructure. Company directors committed to good governance and ethical policies find themselves competing on an unfair basis against corporate delinquents prepared to push tax planning to the limits. Governments committed to equitable tax practices and fair trade find themselves drawn into a wholly bogus process known as tax competition

9 *Ibid*, p. 174.

10 Brittain-Catlin, W. (2005). *Offshore: The Dark Side of the Global Economy.* New York: Farrar, Strauss and Giroux, p. 55-76.

11 See "The Other Side of the Coin: the UK and Corruption in Africa". A report by the UK Africa All Party Parliamentary Group, March 2006, p. 14.

12 Raymond Baker from the Center for International Policy, Washington, quoted from oral evidence given to the UK Africa All Party Parliamentary Group in January 2006.

13 Boyce, J.K. and Ndikumana, L. (2005). "Africa's Debt: Who Owes Whom?" in Epstein, G.A., *Capital Flight and Capital Controls in Developing Countries.* Cheltenham: Edward Elgar.

14 Reich, R. (1992). *The Work of Nations.* New York.

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which undermines their revenue base and increases inequality.

Regrettably, Transparency International, despite its commendable role in putting corruption onto the political agenda, has undermined the efforts of reformers through its publication of the Corruption Perception Index (CPI) which reinforces stereotypical perceptions about the geography of corruption. The CPI identifies Africa as the most corrupt region of the world, accounting for over half of the 'most corrupt' quintile of countries in the 2006 index. African countries account for about one half of the countries identified as most corrupt, with Chad, Côte d'Ivoire, the Democratic Republic of the Congo, Equatorial Guinea, Guinea and Sudan ranking amongst the bottom ten of the 163 countries surveyed. Ghana fares relatively well, ranking at a joint 70th position in 2006, though the ranking score of 3.3 out of a possible 10 still places Ghana at the low end (i.e. more corrupt) of Transparency International's corruption spectrum. But despite the attention given to the CPI in the African and global press, these statistics provide a very partial and biased perspective. A more critical examination of the index reveals that over half of the countries identified by the CPI in 2006 as 'least corrupt' are offshore tax havens, including major centres such as Singapore (ranked 5th overall), Switzerland (7th), the UK and Luxembourg (jointly 11th), Hong Kong (15th), Germany (16th), the USA and Belgium (jointly 20th). For good measure, Barbados, Iceland, Malta, New Zealand and the United Arab Emirates (all tax havens) also fall into the 'least corrupt' quintile. What do these rankings tell us about the current politics of corruption?

This distorted geography of corruption may well arise from Transparency International's definition of corruption as "the misuse of entrusted power for private gain." Operationally, this has led to an obsessive focus on public officials (politicians and state employees) and a lack of attention to other elites, including company directors or financial intermediaries. Now the focus must shift to the enablers on the supply side,[15] including:

- Governments of jurisdictions (not exclusively those categorized as tax havens) which supply the secrecy spaces where corruption can take place.
- Private sector agents, including and especially professional intermediaries such as bankers, lawyers, accountants, company formation agencies and trust companies, whose activities facilitate (or overlook) corrupt financial practices.[16]
- Company directors responsible for illicit transactions that contribute to capital flight, tax evasion and tax avoidance.

Public understanding of what constitutes corruption needs to be radically shifted to encompass any activity which involves the abuse of the public good or which undermines public confidence in the integrity of the rules, systems and institutions that promote the public good. Insider trading, tax evasion and avoidance, market rigging, non-disclosure of pecuniary involvement, embezzlement, and trade mispricing would all be recognized as corrupt within such an analytical framework.

An economic blind spot

Many economists overlook the role of the offshore economy in their analysis, which arguably underlies their inability to explain the 'uphill' movement of capital from poor to rich nations despite the predictions of their economic theories.[17] Political risk or the prospect of financial crises might be primary causes of capital flight, but tax-free status creates a strong incentive for wealthy domestic asset holders in developing countries to retain their assets offshore. By doing this on an anonymous basis, they can protect their wealth from potential currency devaluation and from taxes. But not all the capital that flees developing countries stays out. Some returns disguised as foreign direct investment. This is the consequence of the flight money being re-cast offshore during the laundering process prior to reinvestment in the country of origin: a process known as 'round tripping'. The preferential treatment offered to many foreign investors provides an incentive to round trip.

In March 2005 the Tax Justice Network published a briefing paper – *The Price of Offshore*[18] – which estimated the stock of private wealth held 'offshore' by rich individuals, and largely undeclared in the country of residence, at about USD 11.5 trillion. The paper estimates that the annual worldwide income on these undeclared assets is about USD 860 billion, and that the annual worldwide tax revenue lost on such undeclared income is about USD 255 billion. That figure, which has had huge media coverage since its publication, and which we consider to be on the conservative side, significantly exceeds the annual funds needed to finance the UN's Millennium Development Goals.[19] Whilst the majority of this USD 11.5 trillion of undeclared assets originates from developed countries, a significant proportion comes from developing countries. For example, over 50% of the cash and listed securities of rich individuals in Latin America is reckoned to be held offshore.[20] Data for Africa are scarce, but most analysts assume the ratio to be comparable to Latin America or higher.

But the figure of USD 255 billion in tax revenue lost to tax evasion on assets held offshore is only one part of the equation. Developing countries also lose out to tax evasion in the domestic context (often from activities in the informal economy), from tax avoidance on cross-border trade, and from pressures to compete for investment capital through offering unnecessary tax incentives. In combination these issues are estimated to cost developing countries approximately USD 385 billion annually in tax revenues foregone.[21] This clearly represents a massive haemorrhaging of the domestic financial resources of many developing countries, which undermines sustainability in a number of ways:

- Declining tax revenue income from the wealthy and high income earners forces governments to substitute other taxes (typically indirect) with a consequent regressive impact on wealth and income distribution.
- Falling tax revenues force cutbacks in public investment in education, transport and other infrastructure.
- Tax dodging corrupts the integrity of tax regimes and creates harmful economic distortions which penalize those who follow ethical practice and benefits those who bend the rules.
- Tax dodging undermines public respect for the rule of law and the integrity of democratic government.

Declining tax revenues in developing countries have stimulated a vicious circle of decline in investment in the human capital necessary to create an attractive environment for both domestic and foreign investors. In a 2006 report on Latin America, the World Bank argued that governments must give higher priority to spending on infrastructure likely to benefit the poor and increase expenditure on education and health care. In practice, a large proportion of government spending in Latin America is skewed in favour of the well-off, and governments are collecting far too little tax, especially from the wealthy. The World Bank report concludes that "on the tax front, first items in the agenda would be strengthening anti-tax evasion programs and addressing the high levels of exemptions."[22]

Civil society: wake up!

In April 2007 the author addressed a parliamentary session in London on the subject of "Why are aid donors frightened of taxation?" Several reasons were offered, including the complexity of the subject and fears about the future of some small island

15 See, for example, UK Africa All Party Parliamentary Group, *op cit*.

16 US Senate (2006). *Tax Haven Abuses: The Enablers, the Tools and Secrecy*. Permanent Subcommittee on Investigations.

17 Guha, K. (2006). "Globalisation. A share of the spoils: why policymakers fear 'lumpy' growth may not benefit all", *Financial Times*, 28 August, p. 11.

18 <www.taxjustice.net/cms/upload/pdf/Price_of_Offshore.pdf>

19 For more details about the MDGs see Joyce Haarbrink's article on sexual and reproductive health and rights in this Report.

20 Boston Consulting Group (2003). "Global Wealth Report".

21 Cobham, A. (2005). "Tax Evasion, Tax Avoidance and Development Finance". Queen Elizabeth House Working Paper Series No. 129, Oxford.

22 Perry, G.E., Lopez, J.H., Maloney, W.F., Arias, O. and Serven, L. (2006). *Poverty Reduction and Growth: Virtuous and Vicious Circles*. The World Bank, p. 101.

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economies which are dependent on their tax haven roles. But other factors were also raised: Are some aid agencies compromised by their relations with powerful governments? Do some of them have a vested interest in preserving the aid industry? Are some too closely tied to corporate interests? Whatever the reasons, it is astonishing that it has taken so long for these issues to become the focus of attention for the development community.

Most of the problems outlined above can be remedied by strengthening international cooperation. Effective information exchange between national authorities would go a long way towards overcoming the problems of capital flight and tax evasion. The barriers posed by banking secrecy could be overcome by override clauses built into international treaties. The secrecy of offshore trusts would be reduced by requiring registration of key details relating to the identity of the settlor and beneficiaries. There is no reason why those who benefit from the privileges conferred by using companies and trusts should not accept the obligation of providing basic information about their identity.

Global frameworks could be agreed for taxing multinationals on the basis of where they actually generate their profits. Policies such as these could be implemented in a relatively short timeframe. The principal barrier standing in the way of progress towards achieving these goals is the lack of political will on the parts of the governments of the leading OECD nations, most notably Switzerland, the USA and the UK, all of which are leading tax haven nations. The reality of their commitment to 'globalization' is that they want liberalized trade on their own terms but continue to use fiscal incentives to distort the trade system in favour of their domestic businesses and to attract capital from developing and emerging countries.

The debate around development and persistent poverty is undergoing a major shift. Campaigners are looking beyond aid dependence and debt relief, and all the associated conditionalities, and asking questions about the domestic resources of developing countries. The issues of capital flight and tax evasion, which have gone largely ignored for so long, are moving to the centre stage. At the same time the corruption debate is shifting to focus on the role of enablers and the tax havens through which so much dirty money is shifted en route to the mainstream capital markets. Connections are being made between money laundering, corruption, financial market instability, rising inequality and poverty. And tax havens are being identified as a common denominator to each of these problems.

Addressing this issue in March 2007, anti-corruption campaigner Eva Joly spoke of the need to shift the corruption debate to Phase Two, in which the role of accountants, bankers, lawyers and offshore financial centres in enabling corrupt practices comes under far greater scrutiny.[23] ■

Tax Justice Network and financing for development

The 2002 Monterrey Conference on Financing for Development identified capital flight and tax evasion as barriers to the achievement of this goal. In 2003 the UN General Assembly agreed the creation of a Committee of Experts on International Cooperation in Tax Matters, dedicated to tackling these problems.

In Autumn 2008 the member states of the United Nations will meet in Doha to review progress towards achieving the Monterrey Consensus on mobilizing domestic resources as a principal means of financing development. We must use the Doha summit as an opportunity to highlight the work of this Committee and to push for a new agenda for this Committee, giving primacy to pro-poor tax policies and enhanced international cooperation on tax matters. For those of us seeking solutions beyond aid dependence and debt relief, redesigning the global financial architecture to tackle capital flight and tax evasion is a major priority. This is a struggle which affects us all. Join us!

Further resources

Offshore Watch: <visar.csustan.edu/aaba/jerseypage.html>

Tax Research LLP: <www.taxresearch.org.uk/Blog>

Tax Justice Blogspot: <taxjustice.blogspot.com>

Do we love globalisation?: <taxjustice.blogspot.com/2007_07_01_archive.html>

Tax Justice Focus – the corruption issue: <www.taxjustice.net/cms/upload/pdf/TJF_2-2_print_edition_2006.pdf>

Tax Justice Focus – the tax competition issue: <www.taxjustice.net/cms/upload/pdf/TJF_2-4_print.pdf>

Tax Justice Focus – the inequality issue: <www.taxjustice.net/cms/upload/pdf/TJF_3-1_final.pdf>

23 *Africa Confidential* (2007). "Tax Havens: Financial secrecy – profits from the laundry". Vol. 48, No. 6, 16 March.

Budget support: As good as the strategy it finances

By signing up to the Millennium Development Goals (MDGs), the international development community has made a commitment to turn into reality the right to social security for all. To finance the MDGs aid agencies have promised to deliver more aid in a more effective way. One aid instrument that has risen in prominence is budget support. The term 'budget support' encompasses general and sector budget support. Budget support is an effective instrument when the government is implementing a poverty reduction strategy or a development strategy that its aid partners broadly support. The governments must be able to maintain economic discipline and control public expenditures, and there must be a high level of trust between the government and its partners. In these circumstances, budget support avoids many of the problems that accompany other forms of aid.

Rebecca Carter
Stephen Lister[1]

By signing up to the Millennium Development Goals (MDGs),[2] the international development community has made a commitment to turn into reality the right to social security for all. The International Labour Organization (ILO) definition of social security includes basic health and education services, as well as income security. There remains a strong role for state financing and provision of these services; therefore they will feature strongly in government-to-government aid for poor countries. Typically the requirement is to underpin recurrent costs, not just investment costs of basic services. This article looks at the relevance of budget support to financing the relevant MDGs, and draws some conclusions about the role of budget support, how it should be designed and the attitude civil society organizations should adopt towards it. It draws largely on the Joint Evaluation of General Budget Support[3] in which both authors were involved.

More and better aid promised

To finance the MDGs aid agencies have promised to deliver more aid: donor countries have pledged to meet the official development assistance (ODA) target of 0.7% of gross national income (GNI), and the G8 has pledged to double aid to Africa by 2010.

However, these promises are not being met, and this is putting the success of the MDGs in jeopardy. The United Nations (UN) has shown its serious concern with this state of affairs in the latest MDG progress report: "In particular, the lack of any significant increase in official development assistance since 2004 makes it impossible, even for well-governed countries, to meet the MDGs. As this report makes clear, adequate resources need to be made available to countries in a predictable way for them to be able to effectively plan the scaling up of their investments."[4]

As well as an **increased volume of aid**, the aid agencies have promised, through the Millennium Declaration, the 2002 Monterrey Conference on Financing for Development, the 2005 Paris Declaration on Aid Effectiveness and the 2005 World Summit, to deliver **more effective aid**. Since the late 1990s there has been a growing consensus that inappropriate aid modalities had become part of the problem. Efforts to bypass weaknesses in government systems were seen to have further weakened them, to have fragmented national decision-making, and to have raised the transaction costs of aid. The aid effectiveness debate has led to a new consensus that aid needs to be delivered in a way that promotes harmonization, alignment and recipient government ownership.

Budget support: rise to prominence

In this context, one aid instrument that has risen in prominence is budget support. The proponents of budget support claim that it is an efficient mechanism for delivering scaled up aid effectively. As this view has gained ground, an increasing number of aid agencies have started disbursing more aid as budget support. The European Commission (EC) in a recent proposal declared that "a shift to more budget support will be essential to make effective use of scaled up aid."[5]

Definition and expectations

Budget support is aid funding to government that is not earmarked to specific projects or expenditure items and is disbursed through the recipient government's own financial management system. It is not a new phenomenon: several former colonies received general budgetary grants for some years after independence; balance of payments support – including structural adjustment lending by the World Bank and the International Monetary Fund (IMF) – often generated local currency that governments could use to support their budgets according to their own priorities. More recently, debt relief has been an important form of budget support (for example, when bilateral donors used special debt relief funds to service developing countries' debts to the World Bank and IMF, governments were able to spend an equivalent amount on their own domestic priorities instead).

However, recent forms of budget support have focused more directly on the government budget. They have been designed to support nationally owned poverty reduction strategies in ways that would strengthen national capacity and ensure more sustainable development – hence the designations 'poverty reduction budget support' and 'partnership general budget support'. ('Partnership' is contrasted with the imposed conditionality of the structural adjustment era.)

The term 'budget support' encompasses general and sector budget support. All types of budget support include a lump sum transfer of foreign exchange; differences then arise on the extent of earmarking and on the levels and focus of the policy dialogue and conditionality. Sector budget support is distinguished from general budget support by being focused on a discrete sector or sectors, with any conditionality relating to these sectors. Often the funds are not strictly earmarked to the sector. In practice the design of budget support instruments is a spectrum (see Box 1).

There has been a lack of systematic knowledge on the actual design, practice and effects of budget support, due to its complex nature and the fact that in the form of 'partnership' budget support it has been used more widely only from the late 1990s.

There are a number of assumptions made about budget support. For example, when used to finance country development strategies, budget support is expected to also have a wide range of complementary effects, such as:

- Improved coordination and harmonization among donors and alignment with partner country systems (including budget systems and result systems) and policies.
- Lower transaction costs.
- Higher allocative efficiency of public expenditures.
- Greater predictability of funding.
- Increased effectiveness of the state and public administration as budget support is aligned with and uses government allocation and financial management systems.

1 The authors are members of the staff of Mokoro Ltd which was formed as a not-for-profit company in 1982 to provide technical assistance and support for economic and social development and resource management. <www.mokoro.co.uk>

2 For details of the MDGs, see the article by Joyce Haarbrink in this Report.

3 IDD & Associates (2006). *Joint Evaluation of General Budget Support: Synthesis Report*. May. Glasgow: DFID.

4 United Nations (2007). The Millennium Development Goals Report 2007. New York: UN. Available from: <www.un.org/millenniumgoals/pdf/mdg2007.pdf>.

5 EC (2007). *Technical Discussion Paper on a "MDG Contract". A Proposal for Longer Term and More Predictable General Budget Support*. 19 June. EC DG Development.

- Improved domestic accountability through increased focus on the government's own accountability channels.

Not all preconceptions of budget support are positive: another set of assumptions focus on the risks associated with it. A common view, for example, is that budget support is more vulnerable to corruption than other forms of aid, and sometimes it is crudely characterized as "money for governments to do what they like with."

Joint Evaluation of General Budget Support

The debate on budget support has been moved forward with the completion of the Joint Evaluation of General Budget Support.[6] An independent study led by the International Development Department of the University of Birmingham commissioned by a group of 24 aid agencies and 7 partner governments under the aegis of the Development Assistance Committee (DAC) of the OECD, this was the first systematic attempt to assess to what extent and under what circumstances general budget support is relevant, efficient and effective for achieving sustainable impacts on poverty reduction and growth (see Box 2 for further details).

While the evaluation's focus was on general budget support, one of its findings is that many of the lessons in design and operation of budget support are relevant to both general and sector budget support. This report draws upon the evaluation to explore the assumptions behind some commonly

6 IDD & Associates (2006), *op. cit.*

BOX 1. Design options along the general and sector budget support spectrum

Design feature	General budget support	Design options ←→	Sector budget support
Flow of funds	Transfer money to consolidated fund. Money not associated with any particular sector.	Transfer money to consolidated fund. Money associated with sector or sub-sector, but not tracked. Total spending in sector must exceed total donor contributions.	Transfer money to sector specific bank account so that money can be tracked to sector or sub-sector.
Objectives, dialogue and conditionality	Mainly macro and cross-cutting objectives with dialogue and conditions relating mainly to those two areas.	Sector, macro and cross-cutting objectives with dialogue and conditions relating to all three.	Mainly sector specific objectives, with dialogue and conditions relating to sector.
Associated technical assistance and capacity building	Aimed at strengthening capacity to develop macro policy, build sector-macro linkages and strengthen cross-cutting processes.	Aimed at strengthening capacity at sector level and for some macro and cross-cutting issues.	Mainly aimed at strengthening sector capacity, including sector level planning and budgeting.

Note: The authors are indebted to Jennie Barugh of DFID (UK Department for International Development) for this depiction.

BOX 2. THE JOINT EVALUATION OF GENERAL BUDGET SUPPORT 1994-2004

In 2004 a group of 24 aid agencies and 7 partner governments commissioned a joint evaluation of general budget support. Its purpose was to assess to what extent and under what circumstances General Budget Support is relevant, efficient and effective for achieving sustainable impacts on poverty reduction and growth.

This independent study was led by the International Development Department of the University of Birmingham. Its outputs are seven country case studies (for Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda, and Vietnam), a synthesis report, and six thematic papers:

- What are the effects of General Budget Support?
- When and how should General Budget Support be used?
- How can the risks of General Budget Support be managed?
- How does General Budget Support affect ownership and accountability?
- General Budget Support: Policy Questions and Answers
- General Budget Support: General Questions and Answers

The outputs can be accessed from the OECD DAC evaluation website: <www.tinyurl.com/ry7xj>.

The study countries were an illustrative, not a representative, sample. Nevertheless, the variety of contexts gave opportunities to draw lessons from contrasts as well as similarities between countries. However, the short history of general budget support limits the scope for robust findings at outcome and impact level.

	Country context						PGBS			
	Size	Aid dependency		Government capacity		Duration	PGBS "volume"		Donor involvement	
	Population (millions) in 2000	GNI per capita (USD) in 2000	ODA as a % GNI in 2000	CPIA quintile in 2003	CPIA change from 1999 to 2003	Starting year for PGBS	Flows up to 2004 (million USD)	PGBS as a share of ODA in 2004	PGBS per capita (USD, cumulative)	No. donors providing PGBS in 2004
Burkina Faso	11.3	250	12.9	2	+1	2001	500	25%	44.3	7
Malawi	10.3	170	26.1	3	-1	2000	148	5%	14.4	3
Mozambique	17.7	210	25.4	3	-1	2000	611	19%	34.5	15
Nicaragua	5.1	740	15.0	1	+1	2002	77	4%	15.1	3
Rwanda	7.7	260	17.9	3	0	2000	248	26%	32.2	4
Uganda	23.3	270	14.3	1	0	1998	1,775	31%	76.2	16
Vietnam	78.5	380	5.5	1	+2	2001	570	8%	7.3	9

Source: Synthesis Report, Tables 3.1-3.5 and Figure 3.1.

Notes: The World Bank's Country Policy and Institutional Assessment (CPIA) tool assesses each IDA country's present policy and institutional framework for fostering poverty reduction, sustainable growth and ability to use development assistance effectively. An IDA country is a World Bank classification for the poorest countries eligible for long-term loans at zero interest. PGBS: 'Partnership' general budget support

Source: IDD & Associates (2007). *Joint Evaluation of General Budget Support 1994-2004 – Briefing Paper: What are the effects of General Budget Support?* March. Glasgow: DFID.

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held views regarding the effects of budget support in general. The evaluation also highlights that the interaction between general budget support and sector budget support is an important practical consideration and we return to this in the section on budget support design.

A broader strategy or 'package'

The evaluation found that although budget support money is not earmarked to specific expenditures, it is part of a broader understanding about how the government resources will be used. The finance is accompanied by other 'inputs'. These include: the conditions on which funding is provided and procedures for dialogue between government and donors; donor efforts to harmonize their aid and align it with national policies and procedures; and technical assistance and capacity building. Box 3 describes a typical budget support package.

Only as good as the strategy it finances

Partnership budget support is used to support national poverty reduction strategies, and so it reflects the strengths and weaknesses of those strategies. The first set of Poverty Reduction Strategy Papers focused strongly on expanding access to basic public services, especially primary education and health care. Budget support has been an efficient way of supporting those strategies, but they have had limited effects on growth and on raising the incomes of the poor. Second-generation poverty reduction strategies are paying more attention to growth and income poverty reduction.[7]

The general budget support evaluation concluded that budget support is an effective instrument when the government is implementing a poverty reduction strategy that its aid partners broadly support. The government must be able to maintain economic discipline and control public expenditures, and there must be a high level of trust between the government and its partners. In these circumstances, budget support avoids many of the problems that accompany other forms of aid (e.g. uncoordinated projects that undermine government systems, impose high transaction costs and lack sustainability).

The potential to strengthen government systems

A characteristic feature of budget support is a strong focus on public finance management. This stems immediately from fiduciary concerns about the resources entrusted to national public finance management systems and, more fundamentally, from the budget's role as the key link between policy and implementation. Greater focus on the government budget (as opposed to funds separately dispensed by aid agencies) gives public agencies an incentive to compete for public funds and strengthens the budget process. This also strengthens the formulation of national policies. Budget support strengthens the demand for timely and transparent budgets and expenditure records. This complements technical assistance and capacity building efforts that focus on the supply of technical improvements. Looking at public expenditure management, allocative efficiency is improved by making more funds available to finance poverty reduction strategy priorities and operational efficiency is improved by allowing a better balance between recurrent and capital costs,

BOX 3. BUDGET SUPPORT IS A PACKAGE

Budget support is usually linked to the implementation of a national poverty reduction strategy. The exact arrangements for budget support differ according to the aid agency and recipient country involved, but the typical budget support 'package' includes:

- A basic agreement between the recipient country and its aid partner(s), about the country's aid strategy and objectives, and the general principles of development cooperation. A memorandum of understanding (MOU) often reflects this agreement and sets out arrangements for regular dialogue about general policies and the use of budget support.
- Specific agreements about the amount of budget support to be provided and the conditions for its disbursements. There is usually a general condition that the government will adhere to the broad understandings set out in the MOU, plus specific conditions for the disbursement of budget support funds. The specific conditions usually include a set of agreed policy measures that the government will undertake. Some donors link at least part of their disbursement to the achievement of set performance targets.
- An agreed procedure for monitoring and review of performance. This monitoring and review is integrated into the preparation of subsequent instalments of budget support. Among other things, the budget support donors monitor the country's public expenditures as a whole.
- Budget support is accompanied by programmes to strengthen public finance management, and budget support donors systematically monitor the quality of the country's public finance management systems.
- Budget support is part of broader efforts by donors to align their assistance with the national poverty reduction strategy, to harmonize aid from different agencies, and to make more use of national procedures and systems in the way that aid is provided.
- Budget support is accompanied by technical assistance and support for capacity development, especially to strengthen planning, budgeting and financial management.

Source: IDD & Associates (2007). Joint Evaluation of General Budget Support 1994-2004 – Briefing Paper: General Questions and Answers. March. Glasgow: DFID.

BOX 4. DONOR EXPERIENCES IN COMBATING CORRUPTION

A recent synthesis of donor experiences in combating corruption highlights the following lessons:

- There are no quick fixes, but a need for long-term comprehensive approaches that aim at systemic change.
- There are a variety of entry points for addressing corruption. Explicitly fighting corruption does not have to be the main point of entry: significant work, frequently not identified as anti-corruption, is being done to make improvements to financial systems, procurement, oversight agencies, etc. in the name of efficiency, transparency, capacity building and institutional strengthening.
- A clear understanding of the political economy of corruption is a necessary basis for effective action against it. Experience and specific knowledge of the country context are essential.
- Policy dialogue, if it is based on sound country knowledge, can play a useful role in combination with other instruments, especially in supporting partner country leadership that is committed to change.

Source: OECD (2005). "Final Report of the OECD Development Assistance Committee Development Partnership Forum on Improving Donor Effectiveness in Combating Corruption", 9-10 December 2004. (24 February 2005) OECD DAC.

7 Driscoll, R. et al (2006). *Trade and Growth in Second Generation Poverty Reduction Strategies.* Report for Department for International Development. London: DFID.

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and giving governments more flexibility in the use of funds.

Not necessarily more vulnerable to corruption than other aid instruments

Budget support requires a basic level of trust between partners. Corruption – especially high-level corruption – undermines this. Corruption also corrodes public support for aid in donor countries. Corruption was perceived as a serious issue in all the study countries of the general budget support evaluation but it is inherently difficult to measure. Available data are not robust enough to indicate reliable trends in performance. Corruption can affect all modalities of aid, sometimes in subtle ways (e.g. corruption creates a bias towards capital expenditures, because investment projects offer more opportunities for illicit gain). Aid modalities themselves affect the environment for corruption (e.g. a multiplicity of donor procedures outside of government systems may complicate and undermine the role of national audit institutions; tied aid may create a non-competitive contracting environment). Box 4 highlights lessons of donor experience in combating corruption.

There was no clear evidence that budget support funds were, in practice, more affected by corruption than other forms of aid. Actions against corruption were included in the performance matrices and conditions for budget support in all cases, but highly visible legal measures were rarely very effective.

Budget support's contribution to the strengthening of public finance management (PFM) probably had a more significant effect on the environment for corruption. This is because "the nature and quality of a country's PFM system to a large extent determine the ease with which public corruption can occur."[8] Building on earlier work (notably the fiduciary analyses and assessments linked to the Highly Indebted Poor Countries [HIPC] initiative processes), budget support-related dialogue and technical assistance have continued to support improvements in transparency, procurement management and auditing; their joint involvement in budget support has tended to increase coordination among donors on such issues and added to the collective weight of donor pressure for improvements in government accountability systems. This includes specific measures such as expenditure tracking studies, which are helping to address practical issues in ensuring that resources and services reach their intended beneficiaries.

Budget support donors have also pursued anti-corruption strategies by complementary means, including specific projects and technical assistance to support accountability institutions (audit agencies, parliaments, etc.), and support to civil society organizations.

BOX 5. DAC (2005) GUIDING PRINCIPLES AND GOOD PRACTICES FOR BUDGET SUPPORT

Guiding principles

- Budget support should reinforce partner countries' ownership.
- Budget support should help to enhance the performance and accountability of partner countries' PFM systems.
- Transaction costs incurred by budget support should be minimized.
- Budget support should be delivered in a way that enhances the predictability of resources and reduces their volatility.

Good practices

- Supporting ownership
- Refrain from targeting support
- Reflect partner country priorities
- Focus on results.

Enhancing PFM performance and accountability

- Follow good practices in PFM diagnostic and assessment work
- Directly support the capacity development of partner PFM systems
- Avoid undermining country systems.

Reducing transaction costs

- Streamline conditionality
- Rationalize fiduciary assessments
- Align processes
- Tap the potential of joint donor frameworks
- Time disbursements to facilitate the smooth execution of budgetary payments.

Enhancing predictability and reducing volatility

- Programme budget support over several years
- Align support with partner country budget cycles
- Design conditionality to enhance the predictability of disbursements
- Time disbursements in a predictable manner
- Avoid stop-and-go cycles and allow for graduated responses
- Build public support.

Source: IDD & Associates (2007). Joint Evaluation of General Budget Support 1994-2004 – Briefing Paper: Policy Questions and Answers. March. Glasgow: DFID. Adapted from OECD DAC (2005). Harmonising Donor Practices for Effective Aid Delivery: Volume 2 – Budget Support, Sector Wide Approaches and Capacity Development in Public Finance Management.

Budget support good practices

Complementarity of aid instruments

Budget support tends to enhance the country-level quality of aid as a whole. For example:

- It provides more funds for recurrent costs, so that government can operate the new facilities provided through projects.
- All forms of aid benefit from the strengthening of public finance management systems.
- It promotes better coordination among all donors, and more consistent expenditure plans across sectors.

When large amounts of off-budget project aid continue, the positive effects of budget support are weakened by: fragmentation of the planning and budget process; project management structures that undermine core government capacity; and higher transaction costs for government.

While there is often an important role for general budget support, it is not a complete substitute for other ways of providing aid. Different aid instruments can complement each other. For example, well-designed technical assistance can reinforce the capacity-building effects of budget support; projects can be useful in trying out innovations, or as a way of managing large infrastructure projects.

The general budget support evaluation therefore advocates a portfolio approach which does not assume that one modality is always superior, but rather looks explicitly at the comparative advantages and the complementarities between modalities in any given situation.

The DAC guidelines on harmonizing donor practices for effective aid delivery (see Box 5) imply a stronger discontinuity between general and sector budget support than the study found. There is a spectrum of budget support instruments (see Box 1), and many of the good practices defined for general

8 Dorotinsky, W. and Pradhan, S. (2007). "Exploring Corruption in Public Financial Management". In Campos and Pradhan. Eds. (2007). *The Many Faces of Corruption.* Washington DC: World Bank.

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budget support will also apply to instruments that are habitually referred to as sector budget support. Alignment and coordination among budget support instruments with different (general/sector) orientations is an important practical issue.

Budget support focused on particular sectors could be a useful complement to general budget support, as long as general and sector budget support are carefully coordinated in support of consistent economic and budgetary targets. However, the general budget support instrument (with its associated dialogue and support for capacity development) plays two roles that sector budget support could not provide in isolation: (a) as the focus of support for strengthening overall public finance management, including the budget system; (b) as a force for coherence and alignment across sectors.

Design principles for budget support

The general budget support evaluation report supports the DAC advice, with some additional comments:

- General budget support needs to be conceived (and developed and managed) as part of strategy which takes explicit account of the interplay between different aid modalities and instruments, seeking to exploit complementarities and tackle dissonance between them.
- The findings from the country studies as a whole do not support the idea that there is a standard evolutionary sequence, in which project aid first gives way to sector programmes (or sector basket funds) before the eventual introduction of unearmarked budget funding. They do support the value of moving to the use of government systems as early and as completely as is practical.
- There should be an incremental approach to the use of budget support. It needs to be adapted to country circumstances, and building up effective systems and procedures is an iterative process. Where there are doubts about the quality of PFM systems, both the learning and the incentive effects of initially modest disbursements may be valuable. Aid agencies as well as governments need to learn and to adapt their capacities. Over time, and depending on performance, budget support may be scaled up in several dimensions: in volume of funds (including a contribution to the scaling up of total aid flows), as a share of aid resources, and in terms of the policy and sectoral scope of the budget support dialogue.

The need for predictable and genuinely long-term aid

The 2007 UN MDG progress report shows that adequate resources are still not being made available to countries in a predictable way. Genuinely predictable and long-term aid is not being delivered. Donors are still – by and large – unable to commit to three-year budget support cycles that would facilitate medium-term expenditure framework planning. In practice, even longer-term commitments would be necessary to assure partner governments that they have a stable source of financing for MDG-related recurrent costs of social and other public services. Social security type expenditures need to be predictable, continuous, and not subject to the 'stop-go' features of aid politics.

The DAC good practice guidelines[9] advise that "political conditionality should not be specifically linked to budget support or any individual aid instrument, but rather should be handled in the context of the overarching policy dialogue between a partner country and its donors." Nevertheless, experience shows that budget support, and especially general budget support, is especially vulnerable when there is a deterioration in political relations. This undermines budget support as a long-term instrument. Apart from immediate disruptive effects, it makes partner governments less likely to treat budget support as a reliable source of financing for medium and long-term planning, and this in turn may undermine some of the distinctive benefits of budget support.

The challenge is to find ways of reliably delivering aid through government systems to poor people even when there are political issues with the government. A step in the right direction is the recent EC proposal to provide more long-term and predictable general budget support, which is to be called 'MDG contract' to highlight the contractual nature of its long-term financial commitments and its focus on MDG-related results.[10] However, the EC proposal does not answer all the questions. The EC MDG contract concept is commendable, but it is worrying that it is seen as for 'good performers'. Designs are needed that provide social security for people who live under all sorts of governments.

Practical designs: basic education in Ethiopia

A relevant and interesting example is Ethiopia. Ethiopia presents a direct challenge to Gleneagles and other international commitments concerning the MDGs. The country is exceptionally poor and receives less aid per capita than most of sub-Saharan Africa. Yet the government has demonstrated commitment to poverty reduction, backed by the mobilization of domestic resources and an effective administration. It has an exceptional track record in expanding basic education, and there could hardly be a case more deserving of international support. Yet donors have so far failed to deliver predictable financing on an appropriate scale. Successive Education Sector Development Programmes over nearly a decade have drawn declarations of donor support, but actual financial aid to the education sector has been disappointing. Goodwill has not been converted into long-term predictable funding.

BOX 6. THE PROTECTION OF BASIC SERVICES (PBS) PROJECT IN ETHIOPIA

Key features of the PBS design are as follows:

1. The bulk of PBS funding (Component 1) is disbursed entirely through government systems, but is targeted as additional funding for the federal block grant. Monitoring of PBS includes an **additionality test** to verify that there has been a commensurate increase in the fiscal transfers to regions and *woredas* (local government districts).
2. Monitoring also includes a fairness review to verify that funds are disbursed to all regions and *woredas* in accordance with transparent fiscal rules and without discrimination on political or other grounds.
3. PBS is not earmarked to one sector, but provides support to the basic services for which sub-national governments are responsible, which include primary health care and water/sanitation as well as basic education. This leaves intact sub-national governments' authority to weigh trade-offs across sectors and make decisions, but builds in measures that reinforce the application of agreed fiscal rules in decision-making and greater transparency around them.
4. Component 2 differs from Component 1 as regards both disbursement procedures and earmarking. This component provides funding earmarked for international procurement of medical supplies. These are treated as a special case because of the greater practicality and cost savings available in specialized procurement on behalf of the regions and *woredas*.
5. There is a strong emphasis on accountability:
   - Component 3 provides support to government systems for **financial transparency and accountability**.
   - An innovative Component 4 (**social accountability**) will strengthen the capacity of citizens and civil society organizations to engage in public budgeting processes and hold public bodies to account for the delivery of basic services.
6. The instrument is led and managed by the World Bank, but with deliberate, and somewhat flexible, scope for other donors to provide joint or parallel funding. The principal funders of PBS to begin with have been the UK Deparment for International Development (DFID) and the World Bank.

9 OECD DAC (2005), *op. cit.*

10 EC (2007), *op. cit.*

Aid has been disrupted by political concerns. Direct budget support was suspended in the wake of the civil conflict that followed the disputed elections of 2005. In its place, the so-called Protection of Basic Services (PBS) project was developed and became effective in mid-2006. The PBS programme explicitly recognizes that support to help poor people towards the MDGs should not be jeopardized by the ups and downs of political relationships. (Withdrawing such aid is not an effective way to put pressure on governments, and would not be an ethical approach even if it were effective.) However, the political context required it to be delivered with additional transparent safeguards.

PBS as developed builds on the fact that decentralized governments are responsible for the bulk of primary service provision, largely financed by the federal block grant. PBS therefore augments the federal block grant. PBS arrangements include the monitoring of intergovernmental fiscal transfers as a whole, and include tests of additionality and fairness as well as other fiduciary monitoring. As the largest expenditure commitment of local governments, education is the main beneficiary of PBS funds. Box 6 describes the key features of PBS.

Although introduced as an emergency substitute for more conventional general budget support, the basic services approach is a superior one because it offers credible safeguards against political disruption. However, the PBS instrument is still essentially hand-to-mouth (a one or two-year time horizon for commitments is far too short compared with the eight-year primary education cycle, for example). The principal challenge is to develop the instrument into one that remains politically robust but provides genuinely long-term commitments on a larger scale.[11]

11 Lister, S. (2007). *Scaling Up Aid for Education in Ethiopia.* April. Oxford: Mokoro Ltd.

Conclusion

Budget support is not a panacea, but it should play an important role in meeting MDG commitments. Donors need to demonstrate political will and a willingness to innovate, so as to develop forms of budget support that ensure continuous support to poor people, even when the political context is difficult. For civil society organizations there is also an important role: in advocacy, to hold donors to their funding commitments, and in terms of strengthening social accountability for public expenditures (including aid) in recipient countries. ■

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EU cooperation: De-prioritizing social development

The European Union (EU) is planning its aid programmes with developing countries for the coming period up to 2013. The European Commission has seriously de-prioritized support to social sectors. The interests of the EU itself, in terms of investment and its own competitiveness, feature high on the cooperation agenda, and there are strong connections to counter-terrorism and migration issues. In the case of Africa, social development is de-prioritized, while trade and support to transport and infrastructure are given much greater priority. On the other hand, the lack of inclusiveness in the aid programming process has seriously limited the ownership of the EU programmes proposed for developing countries.

Mirjam van Reisen
EEPA[1]
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Eurostep[2]

The interests of the European Union (EU), in terms of investment and its own competitiveness, feature high on the cooperation agenda, and there are strong connections to counter-terrorism and migration issues. It is much less clear how the strengthened legal framework for poverty eradication is translated into concrete actions, especially to support social development, in areas like health, education and gender equality. The country programmes also lack any focus on the environment.

Importantly, the country programmes lack transparency and accountability. Rarely did consultations take place with stakeholders other than EU regional business forums. Civil society has been consistently excluded from the process in most developing countries, and national parliaments have rarely, if at all, been consulted. Even education, health and women's ministries were generally not included in the priority-setting of the EU programmes. This lack of inclusiveness seriously limited the ownership of the EU programmes proposed for developing countries.

The legal framework for international cooperation

The EU has made some positive advances in the legal framework for its international cooperation. First, negotiations on a new Treaty for the EU include a useful specification and clarification of the legal basis for development aid. The legal basis for development aid is specifically related to all developing countries as defined by the OECD Development Assistance Committee (DAC). Moreover, it prescribes that the objective of EU aid is to eradicate poverty, replacing the rather more confused formulation in the Treaty so far. Originally called the Constitutional Treaty, its level of ambition has recently been modified to fit more modest expectations of EU citizens.[3] However, the current signs are that the legal base will remain included with its focused formulation, expressing the intention of the MDGs (Presidency draft of 23 July 2007).

Second, a new legal base for development cooperation was adopted, called the Development Cooperation Instrument (DCI). Whilst originally a weak proposal from the European Commission, combining cooperation with developing countries and non-developing countries, the final outcome of the legal base is strong and focuses EU development aid on poverty eradication.

Two very important achievements were made in the DCI. One was the recognition of the target introduced by the European Parliament to achieve 20% of basic health and education in 2009. The second is the European Parliament's right to have scrutiny over the country-specific development plans of the European Commission, as well as the responsibility to check and ensure that these are in line with the legal provisions of the EU Treaty and legal provisions.

"We decide, you own"

The preparation of country programmes was severely criticized by non-governmental organizations in the South and in Europe. In the publication "We Decide, You Own", GRAPAD, OAG, COASED, CCGDP and Eurostep documented serious weaknesses in the consultation processes of the European Commission.[4] While the Commission maintained that the focus of its process was determined by the developing countries, the NGOs concluded that no consultations had taken place, which seriously undermined the claim that the Commission proposals were 'owned' in the South.

At a meeting in November 2006, Oxfam Novib director Sylvia Borren dubbed the ownership as 'ownership by the elites'. Eurostep and its partners argued that without civil society engagement, there was no ownership, and it demonstrated that in the context of the programming process there was strong evidence that there was insufficient involvement of civil society.

Social sectors in country programmes

Especially in relation to Africa, the European Commission has seriously de-prioritized support to social sectors. In a publication called 2015 Watch, marking the mid-point of the MDGs, Alliance 2015 observed that since 2001, the EU budget has included targets for allocating aid to basic health and basic education. None of these targets have been met. In the case of basic education, the proportion of aid has actually fallen from 3.99% in 2000 to 2.73% in 2005. Moreover, an analysis of the EU's country programmes for the period 2007-2013 suggested that Europe will continue to miss its targets.

The report identified key concerns related to the programming for Africa. Out of 61 country programmes considered, only five placed priority on education and only two gave priority to health. No action was identified on HIV/AIDS, as this theme was 'mainstreamed'. Gender equality was identified as a priority area in only one country.

The European Commission cites the principle of 'ownership' as justification for its increased emphasis on transport. The 2015 Watch analysis of EU country programmes covering the period 2007-2013 suggested that transport would be a major priority: 19 of the 61 country programmes available foresaw transport as a priority sector for EU support. Moreover, the overall volume of aid available for this sector is set to increase.[5]

Two independent reports released on the health policy of the European Commission concluded that allocations to health had decreased in proportion to the increased aid resources. The proportion of allocations to health decreased from 7% in 1996 to 5% in 2005.[6]

Democratic scrutiny

In 2007, EU aid programmes for Asia, Latin America and neighbouring countries were adopted. They covered the period 2007-2013 and were scrutinized by the European Parliament. This scrutiny followed a

1 <www.eepa.eu>

2 <www.eurostep.org>

3 Van Reisen, M. (2007). "Note on the separation of a legal base between Development Co-operation and Co-operation with Third Countries". Briefing, Brussels, EEPA, July.

4 Eurostep (2006). "We Decide, You 'Own'! An Analysis of the Implementation of European Community Aid to Developing Countries." November.

5 2015-Watch (2007). "The EU's Contribution to the Millennium Development Goals. Halfway to 2015: Mid-Term Review". Ed. Mirjam van Reisen, Alliance 2015, June.

6 Van Reisen, M. and Moore, B. (2007). "An Unhealthy Prognosis. The EC's development funding for health". Action for Global Health, May. Action for Global Health (2007). "Health Warning. Why Europe must act now to rescue the health Development Millennium Development Goals". July.

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battle in which the Parliament insisted there should be democratic control over EU plans for development cooperation with third countries.

In subsequent months the next generation of aid programmes for Africa were to be finalized. In February 2007, the German presidency announced it would ensure these programmes would also be examined by the Parliament. The European Commission has yet to act on this intent and the German presidency has not raised the issue again.

Meanwhile, questions have arisen in the European Parliament recognizing the need for stronger scrutiny over country programmes, especially towards the African, Caribbean and Pacific (ACP) countries. In relation to country programmes in other regions, the European Parliament has already assumed this right. NGOs insist that no distinction should be made for the ACP country programmes, which would equally benefit from democratic scrutiny.[7]

The European Commission is placing strong emphasis on good governance in Africa. It is entirely unacceptable that the aid programmes for African countries should not be allowed to pass through the European Parliament for scrutiny, especially since this scrutiny was applied in the case of Asia, Latin America and neighbouring countries.

Promoting governance or EU interests?

While questions are hanging over the democratic scrutiny of the country programmes for Africa, the European Commission is placing strong emphasis on a governance facility for Africa. The instrument has drawn heavy criticism. Out of a total of 23 indicators, only one is related to the MDGs. Other indicators focus on issues such as migration, trade liberalization and counter-terrorism, with the purpose of negotiating a response to European interests in exchange for EU aid. It is unclear if the signing of European Partnership Agreements (EPAs) establishing new trade cooperation agreements between the ACP countries and the EU will also have an impact on the assessment of the 'governance' in the partner country.

The linking of aid for poverty eradication with European interests through an instrument suggesting that it promotes governance has been severely criticized. It has been suggested that the governance instrument should specify how it judges the quality of governance and promotes it. Questions have been asked on why human rights and democratic governance are not the focus of the governance instrument. Issues have also been raised on the lack of transparency regarding how the governance instrument is used to measure governance in developing countries. The governance instrument does not include any role for civil society in assessing and promoting governance in developing countries.

Budget support and MDG contracting

The European Commission is increasing its general budget support to developing countries. For ACP countries, it has set a goal of 50% of all resources. The latest estimates indicate that approximately a third of resources will be allocated as general budget support. For their part, NGOs have focused on ensuring that the benefits of general budget support are realized, particularly with regard to guaranteeing long-term predictable financing for recurrent costs such as the salaries of schoolteachers and health workers needed for education and health. A report by Oxfam International estimates that more than four million health workers are needed,[8] while Education International has calculated that 18 million teachers are needed.

Following a conference on MDG contracting in July 2007, an EU official told the news agency IPS that the idea of the MDG contract had arisen after the Commission had learned from some ministries of finance that they do not use budget support to hire doctors and teachers because aid had been short term. The official was quoted as stating, on condition of anonymity: "The idea of the MDG contract is to give countries greater certainty, thus making them more confident that they can count on these resources." The official recognized that because this aid would enter the treasury as general budget support, it would be difficult to track how much EU aid ends up in schools or hospitals, adding, "This aid would be mixed with that of other donors. We don't care if it is our money that finances a school. What really matters is the actual results that policies achieve."[9]

At the same conference on MDG contracting, the finance minister of Madagascar welcomed the idea of long-term predictable finance. He also explained that the funding for education was largely ensured by the Fast Track Initiative for Education (FTI), and that the resources made available through the FTI were set aside in a commercial bank rather than the treasury, to ensure that they were available for education.

Despite the question marks raised in relation to budget support and MDG contracting, the idea of MDG contracting has been embraced as a possibility that could allow greater space for essential services in health and education.[10]

At the same time, caution has been urged with regard to the Commission's ambition to count general budget support as health and education assistance. Given that general budget support makes the allocation of donor money to specific sectors impossible, an expert meeting on this issue called for prudence.[11] ■

Benchmarking EU aid

Concerned with the lack of direction in EC aid to support the MDGs, civil society organizations have launched a campaign to set some clear benchmarks for EC aid in order to regain some ownership over the process of EC aid programming for the South. The campaign can be endorsed at: <www.eurostep.org/benchmark>.

7 Ramachandran, J. (2007). "EU-ACP: More Power to Euro-Parliamentarians urged". IPS News, 16 July.

8 Oxfam International (2006). "In the Public Interest, Health, Education and Water and Sanitation for All".

9 Cronin, D. (2007). "New EU contract could fail MDGs". IPS, 14 July.

10 EEPA (2007). "MDG contracting: Making the Case for More Long-Term, Predictable Budget Support from the European Commission". Briefing Note, Brussels, EEPA, 25 June.

11 Alliance 2015 (2007). "Expert Meeting: Measuring the contribution of General Budget Support to social sectors". Brussels, EEPA, 28 February.

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Social (in)security for all: Pension reform in Central and Eastern Europe

The reforms of the social security systems in Central and Eastern Europe (CEE) were not driven by a commitment to better compliance with international human rights standards, but rather by the trends of economic restructuring in these countries. For some countries like Poland, Hungary and Bulgaria, the reforms were more radical and the choice of social security reform paradigm was conditioned by the need for heavy debt servicing, and therefore negatively impacted by the World Bank 'assistance' for such reforms. The social and gender aspects of pension reform were systematically neglected as the ministries of finance were the main architects and actors of the reforms.

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Bulgarian-European Partnership Association (BEPA)

The following critique of pension reform in Central and Eastern Europe (CEE) is based on the analysis and outcomes of research by economic experts who compared the two main paths of social security reform in the region (Mueller, 2003). It is further informed by a critical analysis of the World Bank policy in the region elaborated by independent experts.

An ageing population and the financial troubles facing public pension schemes, as well as a new wave of pension reforms in Latin America, triggered renewed debate about the need to reform old-age security schemes in Eastern Europe in the mid and late 1990s. The international pension controversy over whether to basically maintain a public pay-as-you-go (PAYG) system by adapting its technical parameters, or to implement a private, fully funded pension scheme such as the one introduced in Chile in 1981, brought about non-uniform paradigmatic choices in the countries of the region.[1]

The main factors behind the pension reforms in the CEE were structural: economic transformation, institutional factors and those related to the role of specific political actors. Although Pierson and Weaver (1993) and other economists and political scientists advocate a cautious retrenchment rather than a fundamental regime change in old-age security, in cases of severe demographic crisis, the reforms in the CEE countries showed that a radical paradigmatic change is possible.

But were these changes driven by the principle of social security for all?

The answer is provided by an analysis of the two main patterns of social security reforms followed in countries like Poland, Hungary and Bulgaria, on the one hand, and the Czech Republic, Romania and Slovenia, on the other. These two groups of countries are representative of the two approaches taken to pension reform in CEE, with the rest of the countries being more or less aligned with one of the two.

The two models will be further analyzed through the example of countries representative of each: Poland and Hungary in the first case, and the Czech Republic in the second.

The legacy of the socialist pension system and post-socialist challenges

Pension systems in socialist CEE had reached virtually universal coverage in the 1960s and 1970s, and were marked by a number of other characteristics: they were organized as one-pillar public systems not separated from the state budget or other branches of social security, allowing for different forms of cross-subsidizing; employers' contributions were the only source of financing; the contribution-benefit link was weak; contributions were not registered on an individual basis; and wages from only a small number of working years were considered as relevant earnings. In general terms, both pension differentiation and average benefit levels were low. The retirement age was also comparatively low, typically 60 years for men and 55 for women.

The economic transformation affected the existing PAYG systems in a number of ways. Rising expenditures for old-age security were the result of the shift from indirect to direct transfers that were needed to counteract the erosion of real pension value related to adjustment-induced inflation and to the drastic reduction of subsidies on basic goods and services. On the other hand, the restructuring of state-owned enterprises had an impact on both the revenue and expenditure side of public pension schemes. The privatization, downsizing and closing down of enterprises was accompanied by a mounting number of disability pensions and early retirement policies. The latter brought about an increased number of pensioners and a falling number of contributors to the scheme, which resulted in a continuous deterioration of the system dependency ratio of existing old-age security schemes.

The pension crisis in the late 1990s was brought about by the economic transformation and was not linked to the ageing of the population. The existing old-age security systems had to be reformed both to restore their financial sustainability and to adapt some of the previous design features to the new economic order. At that point it was obvious to experts that the essential reform measures needed included the following: abolishing privileges, introducing employees' contributions, separating pension schemes from other social insurance plans, raising the retirement age, and restricting easy access to early retirement and invalidity pensions. Other, more controversial measures consisted of the separation of pension schemes from the state budget and strengthening the link between contributions and benefits.

Restructuring in Poland and Hungary was not radical enough to restore the financial sustainability of the public pension schemes, and so despite the high contribution rates, their old-age security schemes are dependent on state subsidies. In these countries many of the necessary reform measures, such as raising the pension age and the abolition of privileges, have met with considerable political resistance or have even been blocked by constitutional courts.

By contrast, the restructuring of the public pension scheme in the Czech Republic has contributed to a stabilization of its financial situation, and in the first years after the reform, it was running a surplus of 0.3% of GDP. It should be noted, however, that the differences regarding the financial situation of public pension schemes in Poland, Hungary and the Czech Republic cannot be explained only by the respective extent of PAYG reform. The Czech Republic had the advantage of a more favourable situation in the local labour market, while Poland and Hungary faced a far more drastic decline in the number of contributors to the public pension scheme.

Another reform step, the first move towards pluralization of pension provision schemes, was far less controversial. For example, in Hungary and the Czech Republic, supplementary old-age security institutions – private fully funded pension funds on a voluntary basis – were created in 1994 and a reasonable percentage of the labour force joined these funds. In both cases, a government incentive for participation was provided: a direct government subsidy in the Czech case, and a tax credit in the Hungarian case. More radical voices demanding privatization of pension schemes emerged later in Poland and Hungary.

1 See also the chapters by Aldo Caliari and Fernando Cardim de Carvalho in this Report.

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Pension system reform in Poland and Hungary: the implications of the paradigm choice

Two major conflicting views on pension reform can be identified. On the one side, in line with the traditional continental European pension paradigm, pension administrations, welfare ministries and many social security experts maintained that a radical regime change in old-age security was not necessary, since the reform of the existing public PAYG systems would suffice. To them, fully funded (FF) schemes were acceptable on a voluntary basis only. On the other side, the respective ministries of finance argued that a fundamental regime change was inevitable, and that a private FF pension scheme represented the only appropriate alternative to the financially unviable public old-age security system. This position essentially promotes the Chilean model. In order to overcome this fundamental division, small task forces were set up in both Poland and Hungary to work out a pension reform draft. They were actively supported by the World Bank, which – in the Polish and Hungarian context of high external debt – was able to play the role of a major external actor in pension reform with its internationally well-known stance.[2]

In both countries, the basic conflict between the ministries of finance and the welfare ministries about pension reform was settled in 1996 when a compromise was worked out by the respective task forces. This compromise was essentially a negotiated agreement between both sides with a bias towards the privatization faction.[3]

Thus, in both Poland and Hungary, the new pension system is a mixed scheme, combining a mandatory public PAYG pillar with a partially mandatory FF system.

The first pillar – the PAYG tier – is financed by employers' contributions and part of employees' contributions, and is mandatory for everybody. The public pension scheme will cover acquired pension claims by paying some sort of compensatory pension.

The second pillar – the FF tier – consists of a newly created pension fund system. Membership is mandatory for young people, as a complement to the first tier. While joining a pension fund was made mandatory for all new entrants to the labour market in Hungary, everybody under 30 years of age was required to do so in Poland.

Although the models in Poland and Hungary are strikingly similar, they differ in many aspects, particularly in the range of first-year reforms. For example, Polish reform plans for the first PAYG tier are much more radical.

Given that the privatization of old-age security is only partial, the Polish and Hungarian reforms are not identical replications of the radical Chilean pension reform, but instead resemble the Argentine model. The mixed model followed in Argentina has considerable political economy advantages over the full privatization of old-age security. For instance, the mandatory pension fund pillar is being built rather slowly, and this 'slow track' approach seems more appropriate in the light of the still fragile capital market and high inflation in CEE in the early years of the reforms. Meanwhile, employers' contributions are maintained to finance the obligations of the public scheme, even if the respective employee chooses the FF pillar. Maintaining employers' contributions also complies with the demands of trade unions.

Nevertheless, partial privatization does not avoid all of the pitfalls of the Chilean model. Besides the fact that CEE capital market risks are considerable due to the recognition of existing pension claims,[4] the mixed model can have significant secondary effects which can shrink the PAYG tier as contributions will increasingly be drained away, making the public scheme even more unsustainable fiscally and politically. This implies, according to some experts, that from the medium-term perspective, the mixed model is biased towards a gradual phasing in of the Chilean model.

As a general observation, public pension systems in Poland and Hungary ran deficits which had to be covered by the state budget. In this context, pension system reforms had nothing to do with social policy, and instead, they served to strengthen the position of the ministries of finance. It is not surprising that the Polish and Hungarian pension reforms included a partial switch to a FF scheme, considering that the ministry of finance in both countries basically consisted of neoliberal economists interested in the macroeconomic advantages attributed to the switch to a funded system. Furthermore, the influence of the World Bank was facilitated by both countries' severe external debt problems. Basically, the World Bank was looking for a radical pension reform precedent in CEE, and it succeeded.

A contrasting case: pension reform in the Czech Republic

Contrary to Poland and Hungary, in the Czech Republic the choices made in old-age security reform have been well within the boundaries of the continental European welfare paradigm. The old-age security system consists of two main tiers: a public mandatory PAYG scheme that has been reformed and is running a surplus, and a voluntary private funded system established in 1994, instead of the mandatory one suggested by the World Bank.[5] The World Bank has not had much opportunity to influence the Czech pension reform process since the country's debt problem was considerably smaller than in Poland, Hungary and Bulgaria. The Czech model shows that countries in CEE can successfully diverge from the World Bank model and hence from the highly touted Latin American role model.

The missing gender dimension

In the early years of pension reform in the three countries considered above, gender equality was overshadowed by other concerns that were seen as more pressing, especially the fiscal and macroeconomic framework. Criteria for early retirement were liberalized for both women and men, retirement ages were increased, and pensions were made more individualized and earnings-related. Women entered the period of the reforms with the privileges from the socialist years but also with the inherited gender pay gap and the consequences f the gender segregation of the labour market. However, these inequalities were not analyzed prior to making decisions about the reform paradigm.

In addition, the reforms undertaken in the region tended to eliminate redistribution towards low-income workers in both the public and private pension schemes, which has a greater negative impact on women. Moreover, the partial privatization of pension schemes which took place in Hungary and Poland, as well as Bulgaria, raises a major issue concerning the size of men's and women's pensions as a result of their different average life expectancies. Under the private pension schemes adopted, the use of gender-specific tables leads to lower monthly benefits for women because their savings must, on average, be stretched to cover a longer lifetime.

2 The influential World Bank pension reform proposal basically consists of a three-pillar model of old-age security: a mandatory public pillar with the limited aim of poverty alleviation among the elderly; a mandatory private fully funded pillar linking benefits to costs actuarially; and a voluntary savings pillar. Within this framework, the lion's share of old-age security falls to private pension funds.

3 The Hungarian pension reform laws were passed by parliament in July 1997 and came into force on 1 January 1998, whereas in Poland the reform was scheduled to take effect in 1999 after the relevant legislation had been passed by the Polish Sejm in mid-1997 and late 1998. At almost the same time, pension reforms based on the same approach were initiated in Bulgaria, where the World Bank played the same role in imposing its reform model.

4 The fiscal burden caused will be substantial, since almost 100% of the economically active population was insured in the past.

5 In this way, the Czech government decided to give the emerging local financial market time to cope with the influx of pension capital by lowering its amount considerably.

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WORLD BANK INDEPENDENT EVALUATION GROUP (IEG) CRITICISMS OF THE WORLD BANK PENSION REFORM MODEL

Critique of 'multi-pillar' reforms

The World Bank's model of partially privatized pensions, known as 'multi-pillar systems', has resulted in lower benefits for retirees, in part because of extremely high administration costs for the private accounts that the Bank encouraged, and in stagnant or even declining levels of pension coverage, despite the Bank's claim that coverage would increase with the reforms. In addition, the fiscal cost of diverting contributions away from public pensions into the mandatory private funds favoured by the Bank frequently leads to pressure to reduce spending on other public services.

Despite the rhetoric, the World Bank ignores the gender impact of its pension reforms and does little to expand benefits to unprotected workers

Given the lack of attention that the Bank has paid to the gender implications of its reforms, it is not surprising to discover that they have had a more negative impact on women than on men, a point that has been confirmed by the Bank's earlier study of pension reform in Latin America (World Bank, 2003). As for the Bank's claims that a primary motive of its interventions has been to increase pension coverage, the IEG concluded that in fact, "little support was provided to expanding old-age benefits to workers in the informal economy," and that "the impact of gender on the welfare of the elderly is assessed in only 11% of countries."

Claims about the positive impact of pension privatization on capital markets found to be unsubstantiated

Another World Bank claim over the years has been that privatization of public pension schemes contributes to a country's overall economic growth by stimulating the development of capital markets. The IEG report finds that the Bank had no factual justification for doing so, noting that it had generally ignored financial market conditions in the countries concerned and failed to evaluate the impact that pension privatization would have on financial markets. In other words, the Bank simply acted on blind faith in the magic of the market, since the IEG report concludes that "most capital markets have not developed significantly as a result of multi-pillar pension reform…"

There is no valid reason for forcing pensioners to subsidize private fund managers

It should be noted the World Bank's Latin American department came to a similar conclusion two years earlier, when it found, after examining comparative experiences in Latin America, that private managers generally proved to be very costly administrators and that "financial sector development can take place effectively in the absence of pension privatization."

The World Bank has a distinct bias towards privatizing public pension systems and more appropriate options have been ignored

After analyzing all of the pension reform loans granted by the World Bank between 1984 and 2005, the IEG notes that the Bank "has concentrated on multi-pillar systems rather than PAYG alternatives or non-contributory schemes … Median World Bank lending per country implementing second-pillar reforms was USD 50 million, compared with USD 7 million for those not implementing second pillars." The IEG report adds that in numerous countries "the Bank acted too quickly to support multi-pillar reforms … without examining options for complementary safety-net programmes to protect informal sector workers from poverty in old age."

Furthermore, the IEG observes that the World Bank encouraged several countries to engage in pension privatization even though their macroeconomic situation was highly unstable and government debt was high. For example, it found that the Bank encouraged multi-pillar reforms in 10 countries of Latin America and CEE where inflation was well in excess of 15%, and in four others where fiscal deficits were very high. Consequently, the Bank's reforms add increased pressure on public finances, as pension privatization "will temporarily increase the fiscal deficit because the government must continue to pay pension benefits while some contributions are diverted into private funds."

The IEG study also finds that the World Bank pushed ahead with pension privatization in several countries of CEE and Central Asia despite the fact that they "did not have sound financial systems" when they undertook the reform, thus adding to the risk that the private funds would be mismanaged.

Private sector corruption is ignored, technical assistance is inadequate, and high administrative costs are overlooked

The IEG report notes that the majority of countries where the World Bank sponsored pension privatization had poor corruption control indices, as calculated by the Bank itself. While the Bank claims to encourage regulation and supervision of pension fund managers and financial intermediaries, the report finds that the assistance provided in this area has been insufficient and identifies serious problems in the regulatory structures in several countries where pensions were privatized.

Unfortunately, the IEG report does not examine the problem of the high costs of administering private pension funds as compared to the public systems that the World Bank encourages countries to scale down. The report does no more than acknowledge that the privatized funds "have been criticized for high administrative and marketing costs."

The myth of private funds' immunity to demographic changes

The report mentions the World Bank's continued assertion that funded private pension schemes protect retirees against demographic shifts, whereas PAYG systems are vulnerable. It is disappointing that the IEG does not question this assertion by the Bank's pension experts, since it has been discredited for several years. In 2001, a report from the International Labour Organization (ILO) concluded that the impact of demographic ageing is similar on both types of regimes. ■

Source: World Bank Independent Evaluation Group (IEG), *Pension Reforms and the Development of Pension Systems: An Evaluation of World Bank Assistance*, Washington, 2006.

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World Bank Independent Evaluation Group assessment confirms negative impact

The World Bank has been a major player in pension reform in developing and transition countries for more than two decades. Since 1984, it has granted more than 200 loans to assist pension reform in 68 countries. The publication by the World Bank's Independent Evaluation Group (IEG, 2006) of a major and largely negative assessment of the Bank's work on pension reforms constitutes an important vindication of the criticisms and recommendations for change to the Bank's pensions policy made by trade unions around the world, and specifically in relation to the leading role of the World Bank in designing and implementing pension reforms during the 1990s in Latin America and CEE. Trade unions have asserted that the World Bank could play a useful role by assisting countries to make their public pension systems fully assume their role by increasing coverage of those excluded and by modernizing their administration. Instead, the model promoted by the World Bank has created and exacerbated inequalities.

A statement prepared by Global Unions for the annual meetings of the World Bank and IMF in September 2005 summarized the kind of role that the World Bank could play in improving pensions systems:

> Old-age pension systems do face important challenges in many countries. A starting point for establishing a new system or reforming an existing one must be that any changes to the pension system should be designed so as to improve the system for workers and retirees, not to prioritize unrelated goals such as forcing retirees to give up part of their pension benefits to inefficient private-sector administrators on the pretext that this will help the financial services industry develop. In 2001, the International Labour Organization's annual conference adopted a tripartite consensus on several points concerning the future of social security, including giving highest priority to the extension of those not covered and strengthening, rather than weakening, solidarity systems. The World Bank would do well to revise its own role in conformity with the ILO's consensus when intervening on the theme of old-age security.

All of these deficiencies imply the need for a major revision of the World Bank's approach to and support for pension reform, which also means a revision of the paradigm of social security reforms in the CEE countries that followed this model. This has become even more imperative as countries around the world are recognizing that dismantling public systems and trying to replace them with partially or totally privatized schemes is a recipe for failure. ■

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Social protection in the Arab region: The challenging concept and the hard reality

The link between human security and social security has become obvious and integrated in the new paradigm of national security at large. Social security is a prerequisite for both international and national security and reflects the relationship between state security in general and individual (citizen) security in particular. Moreover, it refers to the quality of life of individuals and to the respect of their human rights. According to current trends, future prospects in the Arab region appear to point towards less protection and further marginalization of the unemployed, the abject poor, and workers in the informal sector. There is an urgent need in the Arab region to develop a new comprehensive social security system that supports the achievement of socioeconomic rights, and preserves the overriding human rights values.

Ziad Abdel Samad and Diana Zeidan[1]
Arab NGO Network for Development (ANND)

> The question of human security has received growing attention from governments and intergovernmental forums in recent years. In the last decade the underlying concept of security has been changing from that of preserving the nation through military, political and diplomatic measures, to one of including individual human elements in the equation. This broadened concept encompasses a state of well-being in which an individual or group has the assurance of protection from physical and mental harm, freedom from fear and anxiety, freedom from want, and the right to live life with dignity.
> *International Federation of University Women*[2]

The International Labour Organization (ILO) has extended the definition of social security to a series of social policies undertaken by the public authorities and has therefore encompassed the duty of the state in establishing appropriate social security mechanisms. Social security is defined "as the set of public measures that a society provides for its members to protect them against economic and social distress caused by the absence or a substantial reduction of income from work as a result of various contingencies (sickness, maternity, employment injury, unemployment, invalidity, old age or death of the breadwinner), the provision of health care and the provision of benefits for families with children."

The link between human security and social security has become obvious and integrated in the new paradigm of national security at large. Social security is a prerequisite for both international and national security and reflects the relationship between state security in general and individual (citizen) security in particular. Moreover, it refers to the quality of life of individuals and to the respect of their human rights.

Social security should be perceived as part of a comprehensive system of political, economic, social and cultural strategies aimed at protecting national security, including human security and political stability within the society.

Although the traditional understanding of social security has evolved during the last three decades, there is still confusion between social security as described above and social protection as the "provision of generalized basic social support for all citizens, regardless of contribution or employment history."

Social security has double objectives: the first is to improve living conditions and to create an enabling environment to bring the poor to an acceptable level of minimum consumption (Handoussa and Tzannatos, 2002). The second is to reduce the risk of the non-poor becoming poor and the poor becoming poorer. The reduction of risks should be sought as well in macroeconomic policies and the functioning of the labour market to create wealth and employment.

However, even the most enabling environment would never eliminate all risks, and social security programmes can play a useful role in catering for the needs of those who do not fully share the benefits of growth or job creation.

The state plays a central role in the development of an adequate system of social security. Access to public services and income protection must be guided by legislation that establishes rights instead of discretional policies or favouritism.[3] The central objective of the state should be to ensure just and sustainable development for all, including emergency or compensatory assistance for specific groups.

The Millennium Development Goals (MDGs)[4] represent an attempt to articulate, in a comprehensive way, the priority areas of social and economic development. They are an important tool to assess the progress achieved in providing social services for basic human well-being. It is highly important to make the link between the eight MDGs and the human rights framework in general.

The countries of the Arab region often lack comprehensive development strategies, especially the social policies component of such strategies. Obviously, there is an urgent need in the Arab region to develop a new comprehensive social security system that supports the achievement of socioeconomic rights, and preserves the overriding human rights values.

This report will analyze the need to develop social security schemes in the Arab countries through a rights-based approach. It considers the risks to social security in the context of regional challenges. It highlights some of the partially successful social protection policies and points out the structural problems that Arab countries need to overcome. The analysis presented by this report contradicts the claims that the current regimes in power have fully provided for the rights of their citizens by adopting the necessary social policies and ensuring adequate social security in the Arab countries.

Social security risks in the Arab region

Enhancing social security is a challenge that all Arab societies are currently facing. It is obviously related to many external and internal challenges. These include the instability of national security in general, the fact that development indicators are very low, and the confusion regarding the meaning and functions of charity, welfare and human rights. These are challenges that contribute to confusion in setting national priorities and adopting relevant social strategies.

National insecurity

The lack of peace and security are permanent challenges and factors of continuous threat in the Arab region, yet they are not properly addressed.

The cost of war and conflicts, in terms of lost lives, displacement, and setbacks to development, continues to be high. This is particularly evident in Palestine, Iraq, Lebanon and numerous countries marred by internal conflict and strife for over a decade, namely a number of Gulf countries, Algeria, Somalia and Sudan.

War and conflicts in the region continue to destroy human and natural resources and negatively impact the social fabric, while diverting government

1 Executive director and programme officer of the Arab NGO Network for Development (ANND). The authors acknowledge the kind support of Kinda Mohamadieh, programme manager of ANND.

2 <www.ifuw.org/saap2001/security.htm>

3 <www.art-us.org/node/66>

4 See details of the MDGs in Joyce Haarbrink's contribution to this Report.

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budgets towards military expenditure instead of investment in social security programmes. Political tensions and conflicts in the Arab region show little sign of abating, highlighting the challenges of undertaking sustainable development objectives under crisis conditions. These conflicts express themselves not only in terms of stunted economic growth, but also in dislocated social and political realities.

The region is the main field of demonstration of the so-called 'war on terror'. This in turn is the pretext used to explain the prioritization of defence and security policies at the expense of development and social security. Expenditures on military and security establishments surpass socioeconomic and developmental expenditures. This trend of wasted resources will probably persist in the short run as states increase their spending on coercive institutions.

The 'war on terror' was launched to address the results of violent tendencies and acts instead of targeting their root causes. Yet it is obvious that the main factors generating frustration and violence are the failure to reach a just and sustainable peace and to prioritize finding solutions to economic and social disparities and gender discrimination, in addition to the lack of freedom and the continuous violation of human rights, and in particular, the right to self-determination and to the freedom of thought and expression.

Lack of respect for human rights

The most universal understanding of social equity is based on the internationally acknowledged set of human rights that encompass the right of all citizens to equal opportunities and to a fair share of development dividends. Therefore, it is highly important to approach the concept of social security from a human rights lens.

The freedom deficit in the Arab region undermines human development and is one of the most painful manifestations of the lack of political development. Citizenship is defined by the nature and the framework of the relation between the citizens and the state. It is a set of rights and duties. Among these rights is the right to enjoy social services such as health, education, housing, employment and an adequate income. These services should be seen as rights and not as gifts provided by the ruling power. The provision of these services should not allow for nepotism, clientelism and corruption. Among these rights, the right of association should be respected. The latter can secure the space for the establishment of unions representing various interest groups. These have a major role in claiming the rights of workers and citizens to adequate social security and in monitoring the implementation of social security schemes.

However, in most of the Arab countries, respect for human rights and the rule of law are sorely lacking. As a result, some of the main prerequisites for developing a comprehensive and adequate social security system, which serves social justice objectives, are absent. This major gap represents a basic obstacle in the process of adopting an adequate rights-based approach to national social strategies.

Briefing: 2007 MDG report for the Arab region

The 2007 MDG report for the Arab region paints a troubling picture of the situation in recent years: 18.2 % of the population in the Arab region lived in extreme poverty (in 2004), and 12.7% (2000) of children under five years of age were underweight.

The report also indicates that 8.6% (2002) of the population was below the minimum level of dietary energy consumption and 20% (2005) of Arab children were not enrolled in primary education.

In addition, nearly 18% (2004) of the whole Arab population lacked access to safe water, and nearly 28% (2004) lacked access to sanitation.

Source: United Nations and the League of Arab States (2007). "The Millennium Development Goals in the Arab Region 2007: A Youth Lens (an overview)".

Low human development indicators

Although some progress has been achieved across the region and within various Arab countries, it is unlikely that the Arab region as a whole will succeed in eradicating poverty and hunger, particularly in the least-developed and non-oil-producing countries (Samad and Mohamadieh, 2005).

These indicators, among many others, reflect the urgent need to address development challenges with a comprehensive approach, and to adopt national strategies for social security in order to improve the population's social and economic situation.

An overarching tendency towards neoliberal economic policies

Social security policies should not be seen as temporary programmes to be implemented during the transition phase while implementing structural adjustment strategies or economic reforms. This reduces social security to safety net programmes, which is the case in many Arab countries.

Moreover, it has been proven that economic growth cannot serve the purposes of employment creation, sustainable development and social equality without the adoption of active policy processes by governments. These policies should aim at securing fair redistribution and avoiding uncalculated crisis, in addition to securing a sustained growth rate and adequate provision of social needs for various local communities.

However, favouring market-oriented strategies tends to bring about a reduction in the role of the state and an increase in the role of multinational institutions by privatizing and liberalizing public services.

The cultural aspect

Within a society where religion and a clan-based network of relations play an important role in daily life, the latter can be viewed as a positive factor in terms of filling the gaps when it comes to the availability of social services. These traditional networks can be seen as an alternative to an efficient and adequate public social security system. But this reality enhances the welfare and faith-based approach rather than the human rights-based approach and understanding of social security.

Despite the positive results that charity and social assistance can bring to society by contributing to poverty alleviation and providing some basic needs, they can distort the real meaning of citizenship. They can strengthen nepotism, clientelism, and tribal, communitarian and religious belonging over citizenship itself.

Social security in the Arab region

In the last decade, Arab states have allocated rather high figures of public expenditure to the social sectors. But too much of this expenditure has been used to develop infrastructure and to pay the salaries of the disproportionately large number of public employees serving in these sectors. In some countries, social expenditures (mainly on health and education) exceed 20% of GDP. These are considered as inefficient and wasteful, especially in terms of the quality of services, the failure to target the groups in real need, and the inability to provide basic social services to the majority of the population.[5]

Globalization has added to the social risk factors in Arab societies as a result of the major restructuring of macroeconomic policies. This restructuring is mainly aimed at lowering government spending on social services and reducing the cost of existing mechanisms for social protection. In addition, many Arab states (especially non-oil countries), like other developing countries, have been left with insufficient funds to face the challenges of unemployment, including the ability to provide adequate public health care services, vocational training and education systems in accordance with the new global workplace, and protection of the retired elderly and people with disabilities.

5 In Lebanon, for example, there are more than 10 channels through which government expenditure on health coverage plans is carried out, including a number of ministries, other government institutions, cooperatives and mutual benefit funds.

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Social security systems ought to be legally mandated, work-based, mostly contributory and state-run; in the Arab countries, they are generally non-contributory, means-tested, based on availability of funds, and run by a mix of public, civil society and individual actors without adequate complementarity and efficient coordination (Nasr, 2001).

Over the past decade, the mix of public and private responsibility for social security began to shift toward reducing the role of the public sector, as many Arab countries introduced market-oriented measures under the rising fiscal pressures, in addition to the pressure exerted by the international financial institutions in this regard. This led to reduced efficiency and lower social expenditures. It is worth noting in this regard that the right to social security cannot be adequately served in the absence of an adequate national system of social security, especially if it is based on mere profit-oriented interventions by the private sector or random intervention by non-governmental organizations.

Civil society organizations often provide crucial support. In many countries they have started to develop their own social assistance initiatives with private local and international support. Many act as executing agencies of public expenditure programmes. However, these services are being mainly provided by philanthropic, faith-based organizations, basically focused on a charity and welfare approach instead of a human rights-based approach. These strategies and policies should go beyond poverty alleviation towards a comprehensive developmental vision and approach.

Finally, as already mentioned above, the lack of freedom prevents people from establishing unions advocating for their rights to social security. Only democratically elected trade unions, labour organizations and professional associations can claim relevant representation of the different interest groups. They can thus lobby for the establishment of an adequate social security system, and also monitor the implementation of such a system.

A FOUR-COUNTRY OVERVIEW

By analyzing and comparing social protection schemes in four Arab countries, Salim Nasr* derived the main characteristics of the social insurance systems in Egypt, Lebanon, Morocco and Jordan. These include:

- Incomplete protection against major social risks.
- Unequal treatment of individuals: "The segmentation reflects the ranking of each category in the power structure."
- Limited coverage of the concerned population: These gaps arise because many private employers do not feel obliged to actually pay contributions or provide benefits. Also, the states' administrative and judicial capacities are often too weak or sometimes too corrupt to enforce accountability and ensure universal coverage within the laws.
- Low level of real benefits: For most workers of the region, pensions promise 70% to 80% of final work salaries, but actual benefits are significantly lower. This is because of the lack of formal indexation mechanisms, national inflation rates and governmental discretionary adjustments.
- Relatively costly and inefficient administration due to the high administration and transaction costs in the region, shortages of needed financial, technical and administrative skills in the institutions, weak monitoring, divided supervision of programmes across ministries and public institutions, and better identification and coverage of eligible recipients in urban areas than in rural ones.
- No financial sustainability. Sustainability is an emerging issue for social insurance systems in the region, and the financial viability of the public funds is a growing concern. In addition, the demographics of the concerned countries are shifting, and systems will come under more financial strain as people have fewer children and live longer, pension benefits grow, more elders need medical care, and there are fewer workers to support them.

* Dr. Salim Nasr is a senior advisor for UNDP-POGAR and was the general director of the Lebanese Center for Policy Studies (Nasr, 2001).

Social security reform for poverty alleviation in the Arab region

Numerous reports (ESCWA, 2004) and research on issues related to social security indicate that few of the government-funded social security programmes have actually been effective.

Tunisia, relative to other Arab countries, has made significant strides in the sphere of social advancement and social progress. According to a policy paper published by the Economic and Social Commission of West Asia (ESCWA) in 2004, the country has taken advanced steps in order to liberate women and promote their role by ensuring gender equity through the Constitution and the Personal Status Law since 1956. Furthermore, the importance attributed to policies addressing poverty, unemployment and social marginalization and the measures undertaken in these spheres are indeed welcomed by civil society actors as well as international institutions. A comprehensive poverty eradication policy has been adopted in Tunisia in order to address the geographic, social and economic aspects of poverty.

However, the comprehensive aspect of social security policies was a top-down reform process that was not implemented in consultation with social partners and civil society organizations. Moreover, social security schemes in Tunisia are far from being equitably distributed among the regions (Kechrid, 2002). Regional disparities are especially evident in the existing gap between the prosperous industrial zones located on the coasts and the poor interior of the country. Moreover, the country faces the same challenges in creating an adequate social security system as other developing countries, especially those challenges concerning the overlap among institutions providing the same services.

By linking the outreach of social security to its poverty eradication strategy, the Tunisian government has established three new sources of financing for poverty eradication programmes: the National Solidarity Fund, the National Employment Fund, and the Tunisian Solidarity Bank.

It is worth adding that the development of the social security system was not paralleled, and with the same pace, by the development of political and civil rights. The Tunisian government, while focusing on the social aspect, is tending towards more economic liberalization and is completely neglecting the political reform agenda.

In **Lebanon**, there have always been large disparities in the distribution of safety nets among the different regions. Successive Lebanese governments have tried to improve social indicators and promote social development. A study conducted by Hyam Mallat in 2004 concluded that government spending on improving social services is not sufficient, and the new social action plan proposed by the Lebanese government in January 2007 acknowledges this fact. The Ministry of Social Affairs allocates around 13% of its total budget to food and housing subsidies for vulnerable social groups such as orphans, the handicapped and the homeless, and

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about 26% to educational and vocational training allowances for the same special categories and very low-income individuals in low-income areas (Nasr, 2001). The Ministry also contributes to health care for poor and vulnerable categories of the population, channelled through 89 health care centres it supervises directly and through subsidies to health facilities run by civil society groups, which provide free care for the poor and special vulnerable groups. In its turn, the Ministry of Health spends around 10% of its budget on primary health care and public health expenditures.

Despite the implementation of numerous social security programmes, the inefficiency of social spending is due to the lack of a clear and comprehensive national social strategy. Such a strategy needs to address the current total absence of coordination among the concerned ministries and stakeholders, which leads to the duplication of efforts and waste of resources.

The social security system in Lebanon also faces serious challenges due to political, legal, and administrative hurdles, particularly the inefficiency of the National Security Social Fund which is under the mandate of the Ministry of Labour.

In **Morocco**, Salim Nasr (2001) shows that despite increasing emphasis on social development during the 1990s, social protection policies are facing many challenges due to the slow economic growth that has been the main cause of rising unemployment, poverty and vulnerability. There has been no single adequate solution to date to improve the efficiency and coverage of the social protection system and to address the needs of different groups in both rural and urban areas. Most of the government programmes are targeted towards the country's urban centres. Although social security outlays have doubled since 1990, the current pension system does nothing to address the safety net problems of the neediest.

The country has undertaken effective reforms in the basic social services sectors, like education and health, by reallocating expenditures towards primary education in order to achieve universal primary enrolment and by increasing public expenditure for health care in rural areas. However, the lack of coordination between ministries remains a major challenge (MNSHD, 2002). Furthermore, social security in Morocco is still essentially based on a charity model and has not been integrated into a national social plan.

In **Egypt**, Magdi Abdel Hamid[6] highlights the link between the macroeconomic policies adopted by the government during the last three decades and the deterioration of the social security system (Hamid, 2007). These policies have also affected the socio-economic situation of the Egyptian population, as is reflected in the figures showing the increase in unemployment, poverty, and social and regional disparities, particularly between the rural and urban areas.

It is worth noting that the Egyptian social security fund depends on the budget of the Ministry of Finance. The latter is borrowing from the fund's surplus in order to cover the deficit in the public budget. This raises major questions about the sustainability of the fund and its future ability to ensure services to the people.

Meanwhile, despite the large proportion of expenditure on social protection (more than a fifth of GDP), Egyptian social security remains inefficient. It fails to fully address the needs of the most vulnerable, while benefiting the higher and middle classes. Social security distribution also reflects the high stratification of Egyptian society. There are six different social insurance schemes for six different groups of workers, but these schemes only provide pensions, while only 40% of the working population is insured against diseases and injuries related to their work, and only 16% of them receive unemployment benefits (Loewe, 2000).

Some oil-rich and mineral-exporting Arab countries have been successful in providing adequate social security support for their citizens. Gulf countries such as Kuwait, the United Arab Emirates, Bahrain, Qatar and Saudi Arabia have used part of their enormous oil dividends to provide free education, health services, family allowances, and sometimes guaranteed employment to their nationals. These countries have also introduced social insurance schemes that provide for injury compensation, maternity and sickness benefits, and old age pensions for the majority of the workforce.

However, a substantial number of immigrants (mostly from South Asia and other Arab countries) live in the Gulf countries with their families but do not benefit from the same services. These benefits have not been extended to the immigrant labour force that carry out most of the low-skilled work but also occupy a significant proportion of skilled jobs.

The key to the success of some oil and mineral-exporting countries in providing social services on a universal basis is the centralized role of the state. However, the rentier nature of the state has transformed social security schemes into services provided by the ruling families to citizens who do not pay taxes. This situation was described by former ESCWA executive secretary general Hazim El Bablawi (1987) with the phrase "no taxation, no representation," which sums up the problem behind the undemocratic process in oil-rich countries: the government is not held accountable for its actions while citizens do not have to struggle for their rights, especially basic social rights.

Overall, despite the achievements in some of the countries, the majority of the population in the Arab region remains vulnerable and is not well protected against major social risks that might occur.

Many middle-income and a few low-income countries have made substantial progress, but even in these countries, significant segments of the population suffer from hunger or malnutrition and lack of access to basic health care, education, sanitation and shelter, especially in the least developing countries. Moreover, the poor in most Arab countries are politically marginalized, deprived of the right to participate, and have little say on the allocation of national resources.

The major obstacles to meeting these needs are political and administrative; it is often not a question of financial capacities but rather the inadequate use of the existing financial, human, and natural resources. Most countries, except for least-developed countries, have adequate resources to mount programmes that can eventually meet most of these needs. However, it will be necessary to shift government spending from the current focus on security, the 'war on terror' and military expenditure towards new priorities.

Highly indebted Arab countries face shortages in public expenditures, mainly those directed to social programmes. The market-oriented policies adopted in almost all the Arab countries lead to liberalization and privatization of services without distinction between strategic and other basic social services. These countries also lack national macroeconomic policies that integrate the aim of empowerment and support of national productive sectors. They tend to accept support from foreign donors regardless of the conditionalities imposed, which often involve purposes and objectives that do not meet the needs and priorities of local communities. Moreover, foreign donors often seek to ensure political stability in the receptor countries and consequently provide support to regimes run by dynasties, dictators and undemocratic political power.

Concluding remarks

Social security in the Arab region has numerous features and weaknesses similar to those faced by many developing countries, but others are specific to the region. Social security systems in the region are obviously inefficient, as real benefits are often low and administrative costs are very high; this raises serious concerns over the long-term financial sustainability of these systems.

According to current trends, future prospects in the Arab region appear to point towards less protection and further marginalization of the unemployed, the abject poor, and workers in the informal sector. Such negative projections stem from the persistence of existing budgetary constraints on social security systems and inefficient public expenditure.

6 Dr Magdi Abdel Hamid is the Chairman of the Board of Directors of the Egyptian Association for Community Participation Enhancement.

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Furthermore, the security agenda in most of the Arab countries lacks two main prerequisites: a human rights orientation and a long-term human development vision. Inadequate privatization and rapid liberalization of national economies, in addition to the influential role of charity and informal social ties, have served to undermine the urgent need to establish comprehensive national agendas for social security.

It is ultimately the responsibility of the state to ensure social security. States should effectively mobilize national resources in order to ensure the adequacy and outreach of social security systems. In the Arab countries, social solidarity reflected by family and community networks in addition to civil society schemes tends to be an effective alternative for a social insurance model targeting people who lack coverage. However, these actors can only complement the role of the state within a comprehensive national strategy; they can never be able to replace it.

In this regard, it is paramount for Arab states to adopt a rights-based approach when formulating and implementing national strategies for social development. The protection of human rights should be among the main factors strengthening the rise of nations. Therefore, social security should not be perceived as a service provided by a rentier state to its clients, but as an unconditional right of its citizens. Furthermore, the right to social security should not only be stated in constitutions and human rights conventions, but must be made effective through public laws and legal guarantees. Social security should be the top priority in national policy-making. ■

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