Dipartimento di Scienze Economiche
Università degli Studi di Firenze

Working Paper Series

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Working Paper N. 23/2012
November 2012

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www.dse.unifi.it

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Stampato in proprio in Firenze dal Dipartimento Scienze Economiche
(Via delle Pandette 9, 50127 Firenze) nel mese di Novembre 2012,
Esemplare Fuori Commercio Per il Deposito Legale
agli effetti della Legge 15 Aprile 2004, N.106

Human development and fiscal policy: comparing the crises of 1982-85 and 2008-11[1]

by

Bruno Martorano, Giovanni Andrea Cornia and Frances Stewart

Abstract. The paper juxtaposes the fiscal policies – and in particular the changes in social expenditures – adopted during the debt crisis of 1982-1985 and the financial crisis of 2008-2011. The paper shows that – contrary to the early 1980s - the governments' responses in 2008-2009 were characterized by the adoption of Keynesian fiscal stimulus packages in which an increase in social spending represented one of the main components. Nonetheless, in 2010-11 fear of debt default and continuous pressures coming from the financial markets pushed many policy makers to introduce austerity packages and cut public social expenditure, offsetting in this way part the prior policy decisions, as already observed in the early 1980s. Econometric evidence included in the paper shows that the factors explaining the difference in policy approaches between the early 1980s and 2008-2009 include greater country autonomy compared with the past, the spread of democracy and the greater attention paid to human development by policy-makers designing fiscal adjustments.

Keywords: financial crises, fiscal adjustment, public social expenditure, human development.

JEL classification: E62, G01, H5.

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[1] Paper prepared for the conference in honour of Prof. Sir Richard Jolly on "From Structural Adjustment to Human Development: Impact on Poverty and Inequality" held at the IDS-University of Sussex on 17-18 November 2011. The authors of the paper respectively work at Unicef-IRC, Florence; the Department of Economics of the University of Florence; and the Queen Elizabeth House, University of Oxford. Corresponding author: Bruno Martorano (email: bmartorano@unicef.org).

1. Introduction

The financial crisis of the late 2000s assumed a global dimension, affecting many countries around the world, in contrast to the debt crisis of the early 1980s which mainly affected developing countries leading to the famous "lost decade". In comparing these two crises, it is relevant to examine not only the extent and characteristics of the macroeconomic shocks, but also the differing government responses. While, in the early 1980s, deflation and monetarism prevailed, a Keynesian approach dominated the policies implemented by different governments during the first phase of the late 2000s crisis. Indeed, policy makers felt the need to react promptly to limit the negative economic and social consequences caused by the macroeconomic shocks. However, fiscal austerity measures were introduced during the second phase of the late 2000s crisis due to the growing level of public deficits and indebtedness, the pressure from financial markets, the high public debt problems of EU countries and a resurgence of orthodox influence over policy.

This paper has dual objectives: on the one hand, we attempt to contrast the management of public social expenditure during the crises of the 1980s and 2008-11; on the other hand, we investigate whether the factors contributing to changes in social expenditure differed between the two crises and whether the debate on human development which increasingly dominated the policy scene from 1990 affected fiscal policy during the crisis.

The paper is organized as follows. Section 2 provides an overview of the two crises and discusses their origins and main macro-effects. Section 3 compares the government policy responses and measures how social expenditures changed during the two crises. Section 4 analyses the factors which contributed to the change in social expenditures in the early 1980s and in the late 2000s. Finally, Section 5 concludes.

2. The macro-economic shocks and their origins

The recent crisis and that of the early 1980s have different origins, characteristics and effects. The origin of the 1980s crisis was related to the large indebtedness of developing countries following heavy borrowing in the 1970s, the changes in

monetary policy in the USA and UK in the late 1970s and the consequent recession in advanced economies. The crisis spread from advanced to poor economies due to the large rise in interest rates, drop in commodity prices and volume of exports resulting from the slowdown in global demand and the sudden contraction of capital flows to developing countries. The fall in exports and increase in interest rates and the consequent inability to cope with servicing the debt generated the so–called Debt Crisis. The regions worst affected were Sub-Saharan Africa (SSA henceforth) and Latin America and the Caribbean (LAC), where the level of debt dramatically increased respectively by more than 50 and 70 points of GDP from the late 1970s to the mid-1980s. Asia was relatively unaffected as the countries of this region generally had not accumulated significant amounts of debt in the 1970s.

In contrast, the financial crisis in the late 2000s had its origin in the housing and banking sectors of developed countries. The attempts to save their financial systems led to a dramatic rise in public debt that pushed some rich countries into a Sovereign Debt Crisis, especially countries in the European Union (EU) who were unable to devalue their exchange rates. In contrast to the previous crises, developing countries were less severely affected. African countries had reduced their large stock of debt thanks to the Heavily Indebted Poor Countries (HIPC) initiative of the early 2000s while the LAC countries had done likewise through a series of re-negotiations, defaults and debt cancellations. Subsequently, they also changed their fiscal policy in order to achieve a low level of public external indebtedness and a high level of reserves.

Nonetheless, the crisis in rich economies affected developing countries via real channels, that is via a decline in export receipts, foreign investments and migrant remittances. A dramatic worsening in the value of trade in primary commodity exports was mainly driven by a large drop in international prices fallowing a major drop in their demand and, subsequently, in output. In 2009, negative changes in the terms of trade were recorded by the countries belonging to the Commonwealth of Independent States or CIS (-19.4 per cent), LAC (-6.1 per cent), Middle East and North Africa or MENA (-16.7 per cent) and SSA (-13.6 per cent) region (Table 1).

Table 1. Percentage changes in the terms of trade of goods and services

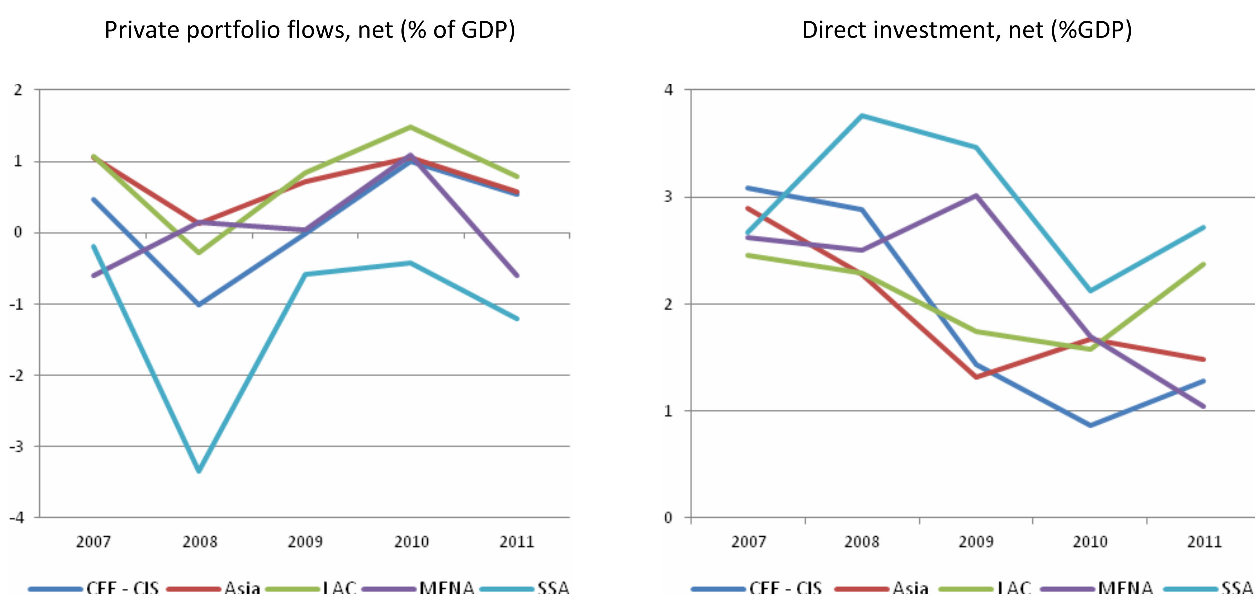
	2005	2006	2007	2008	2009	2010	2011
World							
Advanced Economies	-1.5	-1.1	0.3	-2.0	2.3	-1.0	-1.7
Central and Eastern Europe (CEE)	-0.8	-1.3	2.0	-2.3	3.8	-1.5	0.4
Commonwealth of Independent States (CIS)	13.8	7.7	2.3	18.5	-19.4	12.7	12.0
Developing Asia	-0.9	-0.8	-0.2	-3.1	5.6	-5.5	-1.7
Latin America and the Caribbean (LAC)	3.7	7.0	2.5	3.3	-6.1	8.3	5.5
Middle East and North Africa (MENA)	17.6	5.9	1.2	11.1	-16.7	6.1	11.4
Sub-Saharan Africa (SSA)	9.3	3.0	1.8	4.4	-13.6	20.0	3.6

Source: WEO database Note: the IMF's "International Financial Statistics" database (http://www.esds.ac.uk/international/support/user_guides/imf/Introduction.pdf), defines "*Terms of Trade*" as " index numbers computed from the export and import unit value indices and shown in the appropriate world table. The percent changes are calculated from the index number series. The country coverage within the areas for the export and import unit values is not identical, leading to a small degree of asymmetry in the terms of trade calculation".

Due to the fall in world output as well as to rising tariffs and quantitative restrictions, the volume of world trade as a percentage of GDP decreased by 10 percentage points between 2008 and 2009. All the regions reduced their imports of goods and services with the largest variation recorded by CIS (-26 percentage points between 2008 and 2009). Similarly, the volume of exports of goods and services fell in all regions in 2009 with the one exception of SSA where it remained stable.

There was also a reduction in private financial flows from advanced economies to developing countries (Figure 1), especially in the case of portfolio investment. In 2008, inflows dropped by more than half of their 2007 value in real terms, with the largest declines recorded by CEE and some CIS countries in terms of access to bank lending (UNDESA, 2011). Also FDI declined from 2.5 - 3 per cent of GDP in 2007 to 1 - 2 per cent of GDP in 2010. Only in SSA, did direct investments increase by more than 1 per cent of GDP between 2007 and 2008 although they decreased in the following two years.

Figure 1. Private capital flows to developing regions, 2007-11



Source: WEO database

Furthermore, remittances dropped by around 1 per cent of GDP in emerging and developing countries, losing their traditional countercyclical role in difficult times. In particular, they fell in LAC countries (by about 1 per cent of GDP) and more so in MENA and CEE/CIS countries (by more than 1.5 per cent of GDP). However, there are important differences across regions as remittances remained stable in SSA while they increased slowly in South Asian countries (Cornia and Martorano, 2012).

These are the main factors responsible for the worsened conditions in developing countries in the late 2000s. There are noticeable differences from the 1980s crisis and across regions. In the early 1980s, LAC and SSA were the most affected regions, recording a GDP growth rate respectively of about -0.5 per cent and +0.5 per cent in 1982, and -2.8 per cent and -0.8 per cent in 1983 (Table 2). Conversely, CEE/CIS, LAC and rich countries were the most affected in the recent crisis, recording respectively a percentage drop in GDP of 6.4, 1.6 and 3.6 per cent in 2009 while Asian, MENA and SSA countries showed a positive economic performance (Table 2). Above all, a remarkable difference is found in the trend of world GDP over the two periods. Although world output growth recorded a deceleration during the early 1980s, its growth rate remained positive on average whereas the average world GDP growth rate turned negative in 2009 (Table 2).

Table 2. Annual percentage change in GDP in constant prices, 1980-1984 versus 2007- 2011

	1980	1981	1982	1983	1984	2007	2008	2009	2010	2011
World	1.8	2.2	0.7	2.8	4.9	5.4	2.8	-0.6	5.3	3.9
Advanced economies	0.9	2.0	0.2	3.1	4.9	2.8	0.0	-3.6	3.2	1.6
Emerging and developing economies	3.8	2.8	1.8	2.0	4.9	8.7	6.0	2.8	7.5	6.2
- CEE	-1.1	-1.0	1.1	4.5	3.8	5.4	3.2	-3.6	4.5	5.3
- CIS						9.0	5.4	-6.4	4.8	4.9
- Developing Asia	5.9	5.8	5.6	7.0	7.9	11.4	7.8	7.1	9.7	7.8
- LAC	6.5	1.1	-0.5	-2.8	3.9	5.8	4.2	-1.6	6.2	4.5
- MENA	-1.9	2.5	1.3	2.7	3.5	5.6	4.7	2.7	4.9	3.5
- SSA	4.5	6.8	0.5	-0.8	2.8	7.1	5.6	2.8	5.3	5.1

Source: WEO database

3. Public policy response

3.1. The initial stimulus

As noted, the main concern of this paper is to analyze whether governments responded differently during the recent and the previous crises. The 1980s crisis affected poor economies more severely and many of them sought support from the IMF. However, the standard fiscal and monetary policies recommended by the IMF amplified the size of the macroeconomic shock and increased its duration. These adjustment policies mainly focussed on the spending side. As a result: "real government expenditure per capita fell in over half the countries of the developing world, with a greater proportion declining among countries with the adjustment policies than among those without" (Andersen et al., 1987: 73).

The scenario was completely different at the beginning of the recent crisis due to a broad consensus about the need to adopt counter-cyclical fiscal policies. Beyond the expansionary monetary policies, "during the first phase, most countries—in both the developing and developed world—moved swiftly to introduce fiscal stimulus packages and boost spending" (Ortiz et al., 2012: 174).

According to EC - ILO (2011), this fiscal stimulus was on average close to 4 per cent of GDP with some packages exceeding 15 per cent of GDP as in the case of Georgia and Thailand. Considering 22 countries, Khatiwada (2009) shows that stimulus packages encompassed mainly public expenditure measures, while tax cuts

represented less than one quarter of the packages. Furthermore, there are interesting differences between developed and developing countries. While the latter concentrated mainly on infrastructure spending, fiscal packages in developed countries involved more of other types of additional spending and a greater proportion of tax cuts (Table 3).

Table 3. Composition of fiscal packages, % of total stimulus

	all countries	developed countries	developing countries
infrastructure spending	27.8	14.9	46.5
employment measures[a]	1.8	2.9	0.2
Direct transfers to low income households[b]	9.2	10.8	6.8
other spending	39.8	37.2	43.5
tax cuts	21.5	34.1	3.0

Source: Khatiwada (2009). Notes: [a] As reported by Khatiwada (2009: 18), "employment measures include increasing the number of training centers and services like job search and placement". [b.] This refers to direct cash transfers, conditional cash transfers and unemployment benefits (Khatiwada, 2009).

According to Ortiz et al (2012), more than eight out of ten countries increased public expenditures in the face of the crisis; the largest increase was recorded in MENA countries (6.2 per cent of GDP), followed by advanced economies and CEE–CIS countries (Table 4).

Table 4. Annual public expenditure changes (percentage points of GDP), 2007 – 2009

	2007 – 2008	2008 - 2009	**2007 - 2009**
Advanced economies	1.9	4.0	**5.9**
Central and Eastern Europe and Commonwealth of Independent States	1.2	3.8	**5.0**
Developing Asia	0.9	2.1	**3.0**
Latin America and the Caribbean	0.7	1.9	**2.6**
Middle East and North Africa	2.0	4.2	**6.2**
Sub-Saharan Africa	1.5	1.9	**3.4**

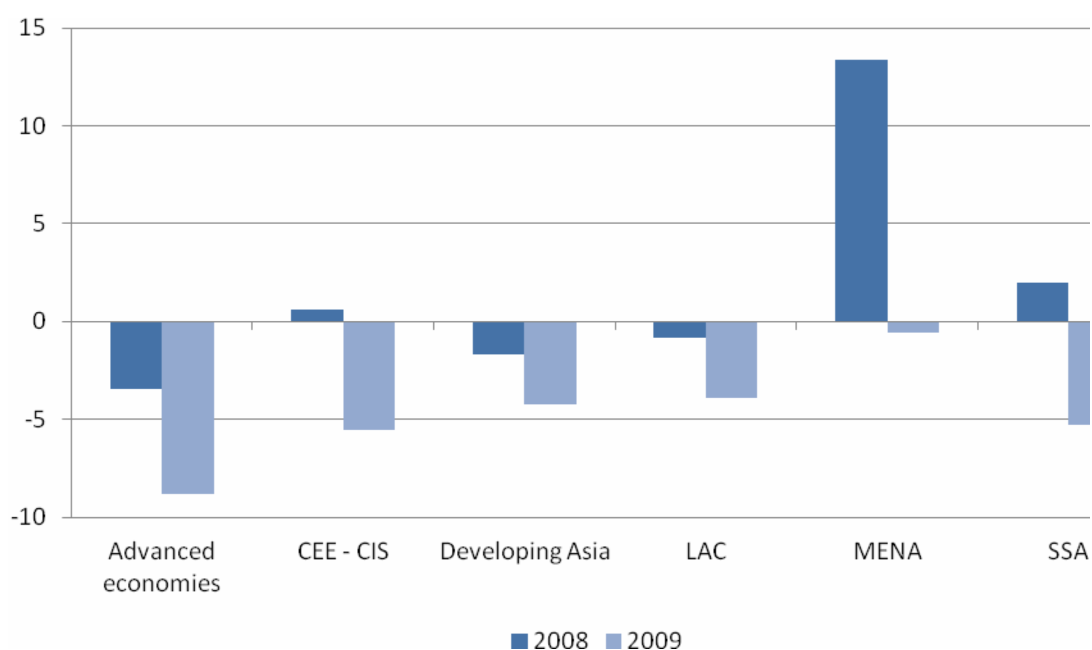
Source: WEO database

Because of the poor economic conditions prevailing in many countries, the IMF regained some of its role as economic advisor and emergency lender, establishing new and much enlarged loan facilities with easier access. Moreover, its response to the

crisis differed from its previous stance, with more flexibility in its conditionality and more tolerance for unorthodox policies (Broome, 2010). Indeed, the IMF considered a fiscal stimulus useful and in some degree necessary in the first phase of the crisis (Spilimbergo et al, 2008).

However, the persistence of the economic downturn led to a drop in government revenues especially in CEE/CIS and SSA (respectively by 2.4 and 5.4 per of GDP between 2008 and 2009). As a consequence of this and of the fiscal stimulus, almost all regions experienced large and widening fiscal deficits. As shown in Figure 2, the largest deficits were recorded by advanced economies (-8.8 per cent of GDP) followed by CEE/CIS countries (-5.5 per cent of GDP) and SSA countries (-5.3 per cent of GDP).

Figure 2. Fiscal Balance (%GDP) in 2008 and 2009



Source: WEO database

3.2. From fiscal stimulus to consolidation

The initial Keynesian approach in developed countries was swept away by the rapid accumulation of sovereign debt and the return of a neoliberal policy stance. As Aizenman and Jinjarak (2010: 7) explained "the sense of urgency and the will to move

policies in tandem during the peak of the crisis has been replaced with extensive debates among countries regarding the future course of macro policies, and growing 'fiscal fatigue'".

Also, the IMF soon reverted to its traditional position, emphasizing a new need for fiscal austerity and especially the necessity to cut public spending (IMF, 2010c). In particular, "the consolidation strategy, particularly in advanced countries, should aim to stabilize age-related spending in relation to GDP, reduce non-age-related expenditure ratios, and increase revenues in an efficient manner" (IMF, 2010c: 4). Nonetheless, there continued to be some differences compared with the past. For instance, IMF (2010a: 11) suggests that "an abrupt, front-loaded tightening is risky and should be avoided, except when market conditions make it inevitable".

Although the negative effects of fiscal tightening on GDP growth and employment were clear, it was believed that fiscal adjustment was inevitable to gain credibility with international markets and to reduce the negative impacts of high debt on economic performance. This was especially marked in the Eurozone, where countries were unable to adjust their exchange rates and the accumulating debt threatened the stability of the Eurozone as a whole.

Consequently, many countries implemented austerity packages from 2010. In the developed countries, the aim was not only to reduce the high levels of public indebtedness but also to rebuild fiscal space that had been eroded in 2008 and 2009. Although their level of indebtedness was much lower, fiscal consolidation was also recommended in developing countries in order to avoid an escalation of debt and the risk of rising inflation.

Based on a review of 158 IMF country reports, Ortiz et al. (2012) show that in more than seven out of ten countries wage cuts and salary caps had occurred or were planned. For example, the government of Ireland introduced wage cuts in the public sector; and some African countries adopted caps on the hiring of civil servants and a freeze on the salary levels in the public sector. Moreover, about half of the countries planned to reduce the value of subsidies on energy (e.g. in SSA countries) and food (e.g. in MENA countries) (Ortiz et al., 2012).

With respect to tax changes, the most common measures concerned indirect taxation, while a few countries – such as Iceland and Ireland - introduced changes in income taxation. Among the most common responses, was an increase in VAT rates or the introduction of new excise taxes. In addition, – as reported by Ortiz et al. (2012) - several countries were considering the possibility of taxing more products, such as basic foods (e.g. Ethiopia, Jordan and Moldova) or fuel and energy (e.g. the Dominican Republic, Jordan, Kyrgyz Republic, Mexico and Turkey). It is known that these taxes have a regressive incidence and contribute to fuel and food poverty and inequality. Indeed, some countries – such as Ghana - tried to increase taxation in a more equitable way, raising the taxes on luxury goods, while other countries aimed to compensate for the increase in the fiscal burden by introducing exemptions (e.g. for basic commodities in Antigua and Barbuda) or reducing taxes on goods (e.g. on fuel and food staples in Kenya) with a high incidence in the budgets of the poor. Generally, the programs of fiscal consolidation implemented in 2010 differed between developed and developing countries. While advanced economies and CEE countries preferred to introduce cuts on expenditures, "emerging economies foresee greater reliance on revenue recoveries" (IMF 2010b: 37).

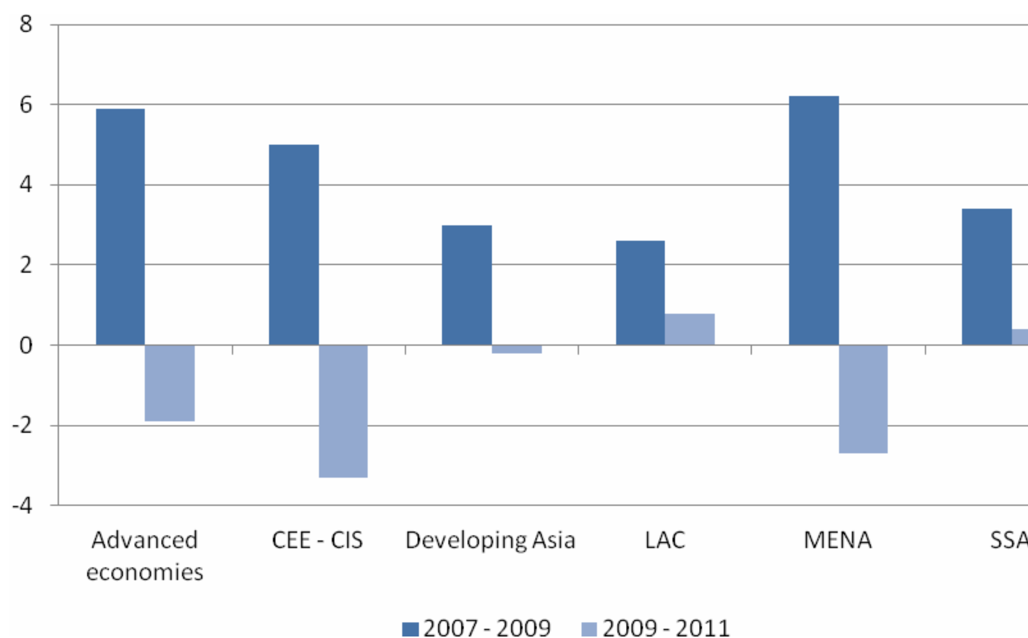
Finally, several countries tried to strengthen their fiscal institutions by changing fiscal rules. Compared with the past, the second generation of fiscal rules is more sophisticated and assures more flexibility and autonomy for policy makers in tackling cyclical changes. These rules have the potential to play a crucial role in disciplining local governments and coordinating policy among the different levels of government during fiscal consolidation, as occurred in Latin America in the early 2000s.

Overall, public expenditure decreased in most countries: on average about one out of two developing countries and about three quarters of countries in CEE/CIS and MENA implemented cuts (Ortiz et al., 2012). In particular, public expenditure decreased by 3 per cent of GDP in CEE/CIS and MENA and two per cent in advanced economies (Figure 3). Conversely, public expenditures remained stable in developing Asian countries and increased slightly in LAC and SSA (Figure 3).

However, the contraction during the austerity period was not enough to offset the expansion in public spending recorded during the first phase. Consequently, public

expenditure showed a positive change in each region in the crisis of the late 2000s in contrast to what happened during the crisis of the early 1980s.

Figure 3. Public expenditure changes (GDP points) over the period 2007 – 2009 and the period 2009 – 2011



Source: Martorano and Cornia (2012)

3.3. Is it old hat? A comparison of the management of public social expenditure between the crisis of the 1980s with that of the 2008-10/11 period

In this section we compare the changes in the composition of public expenditure during the two crises. In particular, we classify public expenditure by function, over three periods: the period 1981 – 1985; and the periods 2007 – 2009 and 2009 – 2010 so as to capture the different impact of the fiscal stimulus and of the fiscal consolidation of the latter crisis.

i) Social Protection Expenditure[2]. Social protection includes expenditures on transfers to people, such as pensions, unemployment benefits and other transfers, which in principle should increase during economic difficulties. Yet many studies show that social protection expenditure is often less protected than other expenditures during fiscal adjustment.

Indeed, Table 5 shows that social protection expenditure dropped in all regions in the early 1980s. It decreased on average in almost half of the countries included in our analysis. This percentage increased to more than 50 per cent in developing Asian, MENA and SSA countries, while slightly less than 1 out of 2 introduced cuts in Latin America countries (Table 5). The largest variation was recorded by developing Asian countries (-13.5 per cent) followed by SSA (-6.6 per cent) (Table 5).

The scenario was completely different during the recent crisis. Indeed, Zhang et al. (2010) show that additional social protection measures constituted about one quarter of the total cost of the stimulus packages and in some countries close to 50 per cent (e.g. South Africa, Singapore and Taiwan). Table 5 shows that almost seven out of ten countries increased the resources devoted to social protection. In particular, the majority of countries in SSA, Developing Asia and LAC raised their expenditure on social protection rather than cutting them as they had done in the 1980s. In rich countries and CEE–CIS, the percentage of countries increasing their expenditures on social protection rose to more than 90 per cent, but only three out of ten countries in the MENA region increased this expenditure in the recent crisis (Table 5).

The majority of the increases in social protection expenditures were concentrated in the first phase (2007 – 2009). In 2010, social protection spending decreased slightly in all regions excluding CEE/CIS countries where it remained stable and SSA countries where it continued to increase (Table 5). However, the decline in public expenditure on social protection during the years of fiscal austerity (2009-10) did not fully offset its previous expansion during 2007-9.

[2] According to the IMF's (2001: 76) functional classification of expenditure, social protection includes spending on: sickness/disability; old age; survivors;; unemployment; family/children; housing; R&D social protection; social exclusion n.e.c.; social protection n.e.c.

Table 5. Changes in public spending for social protection (% of GDP) by period

	Change in public spending *(Variation in percentage points)*			Percentage of countries where public spending Increased (decreased)		
	1981-85	2007-09	2009-10	var 1981-85	var 07-09	var 09-10
Advanced economies	-0.2 (*-1.6*)	2.6 (*18.7*)	-0.2 (*-1.2*)	27 (14)	100 (0)	17 (4)
CEE – CIS		2.6 (*26.0*)	0.0 (*0.2*)		86 (0)	16 (26)
Developing Asia	-0.2 (*-13.5*)	0.2 (*21.4*)	-0.1 *(-9.6)*	33 (50)	85 (14)	13 (38)
LAC	0.0 (*-0.7*)	0.7 *(13.4)*	-0.1 *(-3.8)*	27 (45)	80 (20)	27 (45)
MENA	-0.1 (*-2.6*)	-0.1 *(-1.0)*	-1.0 *(-10.9)*	29 (57)	60 (20)	33 (66)
SSA	-0.1 (*-6.6*)	0.3 *(12.4)*	0.1 *(3.4)*	33 (56)	71 (14)	60 (40)

Source: authors' elaboration based on GFS – IMF data and Martorano and Cornia (2012) database. Notes: the number of countries included in each region varies across the different analyses and periods. Countries that experienced a variation between -5% and +5% are considered stable.

When looking at the composition of social benefits during the recent crisis, it is important to underscore the differences among countries. The largest increases in advanced and CEE–CIS economies were on contributory social security benefits. In contrast, in LAC and East Asia the biggest increase was in the expenditure on non-contributory social assistance benefits.

In the developing countries, governments supported poor families by introducing new cash transfer programs or by extending existing ones. In China, a new rural pension scheme was introduced covering 24 per cent of eligible rural residents by the end of 2010 (Lei et al., 2011). New welfare programs were also introduced in Pakistan (*Benazir Income Support Programme*) and the Philippines (*Pantawid Pamilyang Pilipino Program or 4Ps*) in 2008.

In LAC, governments expanded or increased the benefits from existing conditional cash transfer programs; for instance, the Argentinian and the Brazilian governments expanded the coverage of their programs – respectively *Asignación Universal por Hijo* and *Bolsa Familia*. In SSA also, existing programs were extended or new programs were implemented to protect people from the effects of the crisis. For example, "Ethiopia introduced wheat subsidies to ease the impact of inflation on the urban poor and vulnerable rural populations. Senegal created a cash transfer programme for mothers and young children, and Namibia and South Africa enhanced support grants

for the elderly and children, while increasing spending on health and low-income housing" (UNDESA 2011: 87).

ii) Education and Health Expenditures. In "Adjustment with a Human Face", Andersen et al. (1987) show that governments cut health and education expenditures in reaction to the crisis of the early 1980s. As Tables 6 and 7 confirm, the cuts on education and health are evident in LAC and SSA which were the regions most affected by the crisis. In addition, it should be noted that while in LAC the government protected health spending more than education, the opposite was true for SSA. Indeed, education spending decreased in three quarters of Latin American countries during the crisis of the early 1980s, while health spending remained stable or decreased in the vast majority of SSA countries (Table 6 and 7).

The cuts led to problems in the education and health sectors in both regions. For example, Andersen et al. (1987) reported that in Ghana, there were problems with a project of immunization against yellow fever, while in Mozambique, there were deficiencies in primary health care services. As Cornia et al. (1992: 21) reported "the general squeeze on health resources and the persistent bias in favour of urban hospitals made it increasingly difficult for governments to fulfill their commitment to primary health care". Similarly, in the education sector the introduction of fees in African countries reduced the enrollment rates in primary schools and the quality of educational services deteriorated (World Bank, 1995).

In the 2000s crisis, the situation was completely different. As part of the fiscal stimulus packages, governments increased their expenditures on health. UNDESA (2011: 86) reports that several countries "announced direct or indirect health funding, such as increased spending on public health (China, Honduras, Indonesia, Japan, Kenya, Peru, South Africa, Thailand, United States), compensation for contributions to statutory health insurance schemes (Germany), health insurance assistance (Switzerland, United States)". Consequently, public expenditure on health increased in every region over the period 2007 – 2009. It went up in eight out of ten high-income and LAC countries and about half of SSA and Asian economies (Table 6).

Table 6. Changes in public spending in health in the two crises period (percentage of cases)

	Change in public spending *(Variation in percentage points)*			Percentage of countries where public spending Increased (decreased)		
	81-85	07-09	09-10	var 81-85	var 07-09	var 09-10
Advanced economies	0.4 *(12.6)*	0.8 (*12.3*)	-0.1 (*-1.1*)	36 (23)	92 (0)	4 (13)
CEE – CIS		0.5 (*13.4*)	-0.1 (*-2.4*)		76 (10)	18 (32)
Developing Asia	0.2 (*16.6*)	0.2 *(16.6*)	- 0.1 *(-5.5)*	63 (25)	70 (30)	40 (30)
LAC	-0.1 (*-4.5*)	0.6 *(20.2)*	-0.2 *(-6.7)*	27 (27)	83 (11)	13 (33)
MENA	0.2 (*9.9*)	0.2 *(7.7)*	-0.3 *(-13.4)*	43 (29)	50 (17)	0 (50)
SSA	-0.2 (*-11.7*)	0.2 *(9.6)*	0.2 *(7.7)*	11 (33)	50 (31)	60 (20)

Source: authors' elaboration based on GFS – IMF data and Martorano and Cornia (2012) database. Notes: the number of countries included in each region varies across the different analyses and periods. Countries that experienced a variation between -5% and +5% are considered stable.

Nonetheless, governments implemented some spending cuts during the fiscal consolidation period (2009 – 2010). For example, "Ireland has reduced both pay and non-pay outlays in the health sector (including through voluntary redundancy schemes and reduced fees), and Greece and Portugal have advanced reforms of their health care systems with a view to containing spending" (IMF, 2012: 24). With the exception of SSA countries, health expenditures decreased in every region, though the size of the changes was not large enough to offset the previous increase (Table 6).

Stimulus packages also included measures directed towards the education sector. Indeed, several poor countries concentrated their efforts on primary education providing help to poor households while other countries - such as China and Saudi Arabia - tried to expand the supply of educational services (Khatiwada, 2009). As a result, education expenditure increased in all regions apart from MENA countries. In particular, it increased in eight out of ten Latin American countries and in seven out of ten developing Asian and developed countries. Moreover, education spending rose also in the majority of CEE – CIS countries and increased in 40 per cent of the SSA countries (Table 7).

As for health, like government expenditure as a whole, it is possible to distinguish two trends: one covering the phase of fiscal stimulus (2007 – 2009) and the other the time of austerity (2009 – 2010). In the first period, education spending increased by more than 15 per cent in Latin America and by about 10 per cent in advanced economies, CEE – CIS and developing Asian countries. In the second period, this type

of expenditure dropped slightly in MENA, CEE – CIS and Latin American countries, while it remained stable in rich countries and rose in SSA and Developing Asia (Table 7).

Table 7. Changes in public spending in education in the two crises period (percentage of cases)

	Change in public spending *(Variation in percentage points)*			Percentage of countries where public spending Increased (decreased)		
	81-85	07-09	09-10	var 81-85	var 07-09	var 09-10
Advanced economies	-0.2 *(-5.5)*	0.5 (*9.6*)	0.0 (*0.6*)	14 (41)	87 (0)	13 (9)
CEE – CIS		0.5 (*10.8*)	-0.2 (*-3.9*)		80 (10)	5 (42)
Developing Asia	0.3 (*13.6*)	0.2 (*7.8*)	0.1 *(2.3)*	75 (0)	50 (40)	29 (43)
LAC	-0.3 (*-11.6*)	0.7 *(16.2)*	-0.1 *(-2.2)*	8 (75)	76 (12)	9 (18)
MENA	0.3 (*5.9*)	-0.5 *(-9.1)*	-0.3 *(-5.7)*	57 (29)	0 (50)	0 (50)
SSA	-0.1 (*-2.1*)	0.0 *(-0.3)*	0.2 *(4.9)*	33 (33)	36 (27)	33 (0)

Source: authors' elaboration based on GFS – IMF data and Martorano and Cornia (2012) database. Notes: the number of countries included in each region varies across the different analyses and periods. Countries that experienced a variation between -5% and +5% are considered stable.

Comparing government responses in the two crises, it is evident that countries gave more attention to the health and education sectors in the second crisis. An indication of this comes from the different reactions of the African and Latin American regions during the two episodes. In general, although the second phase of the 2000s crisis was similar to the early 1980s, the changes implemented then were not sufficient to offset completely the increases introduced during the fiscal stimulus phase. Of course, this austerity phase is not complete, at the time of writing, and continued cutbacks may mean a net worsening in expenditure over the subsequent years.

iii) Other expenditures. In relation to the remaining public expenditures, there were no significant changes in terms of defence, public order and safety, environment protection, housing or communities and recreation expenditures in either crisis (Table 8).

More evident were the changes in expenditures on economic affairs[3], and general public services. Over the period 1981 - 86, public expenditure on economic affairs fell in all the regions considered with the exception of the SSA countries where it remained stable. Table 8 shows that the largest cuts were implemented in the LAC

[3] As defined by the IMF's functional classification.

and Asian countries. During the first phase of the recent crisis, economic expenditures increased slightly almost everywhere. Indeed, Khatiwada (2009) shows that the rise in spending on infrastructure was one of the most important components of the stimulus packages implemented by developing countries. In the fiscal consolidation phase, expenditures on economic affairs continued to increase in MENA and SSA. While the other regions government reduced this expenditure, these reductions did not offset the previous increases (Table 8).

Table 8. Changes in public spending on general services and economic affairs (% of GDP)

	General Public Services			Economic Affairs		
	1981-1985	2007-2009	2009-2010	% var 81-85	% var 07-09	% var 09-10
Advanced economies	-0.2	0.4	-0.2	-0.1	0.7	-0.1
CEE – CIS		0.6	-0.4		0.4	-0.3
Developing Asia	0.5	0.7	0.4	-1.3	0.5	-0.5
LAC	0.0	0.4	0.1	-1.6	-0.1	-0.1
MENA	0.5	-1.6	0.9	-0.3	0.2	0.7
SSA	-1.1	1.3	-0.4	0.0	1.2	0.7

Source: Authors' elaboration based on GFS – IMF data and Martorano and Cornia (2012) database. Notes: the number of the countries included in the different periods is not the same.

Governments' responses were far more heterogeneous in the case of expenditures on general public services. In the early 1980s, the most evident change was among SSA countries which reduced this type of expenditure by more than 1 percentage point of GDP (Table 8). In contrast, the same expenditures rose by 1.3 of GDP in the late 2000s. Expenditures on general and public services also increased during the fiscal stimulus period in the other regions with the exception of MENA where it decreased. Moreover, during the fiscal consolidation period these expenditures remained stable with – again - the exception of MENA countries where expenditures in general and public services increased by about 1 per cent of GDP.

iv) Changes in public expenditure composition. The changes in public expenditure composition give an indication of government priorities during the crises. A component of public expenditure can be defined as either 'protected' or 'vulnerable' depending on whether its share in total expenditures increases or decreases.

Using this approach, Table 9 shows that expenditure on economic affairs was particularly vulnerable in the early 1980s in developing countries and its share in total expenditures decreased the most. Although on average economic affairs expenditure

was protected in SSA, a disaggregated analysis shows that it was protected in less than 50 per cent of countries while cuts were significant in more than 30 per cent of them. Expenditure on social protection was vulnerable in high-income countries while the health sector maintained its share in total public expenditure. Finally, expenditures on general public services and on education were protected in the Asian and MENA countries (Table 9).

However, a completely different pattern can be observed in the recent crisis. Excluding the MENA countries, the most protected expenditure was that on social protection. During the first phase of the recent crisis, its share in total expenditure rose in CEE–CIS, developing Asia and LAC and remained stable in the other regions; during the second phase, the share of social protection expenditure continued to increase in CEE–CIS and remained stable in the other regions. With regards to the health sector, the situation was similar to that of the early 1980s. A noticeable difference concerns education spending in the LAC countries which, in contrast to the previous crisis, was more protected than other sectors. As for the expenditure on economic affairs, in most cases governments had similar reactions to the early 1980s introducing cuts especially in the second phase of the recent crisis. Thus – between 2009 and 2010 - there were no major changes in public expenditure composition.

Table 9. Changes in public expenditure composition

		Advanced economies	CEE – CIS	Developing Asia	LAC	MENA	SSA
General Public Services	81-85	=		↑	=	↑	↓
	07-09	=	=	↓	=	↓	=
	09-10	=	=	↑	=	=	↓
Economic Affairs	81-85	=		↓	↓	↓	↑
	07-09	=	=	=	↓	=	↑
	09-10	=	=	=	↓	↓	=
Health	81-85	=		=	=	=	=
	07-09	=	=	=	=	↑	=
	09-10	=	=	=	=	=	=
Education	81-85	=		↑	↓	↑	=
	07-09	=	=	↑	↑	↓	=
	09-10	=	=	=	=	=	=
Social Protection	81-85	↓		=	=	=	=
	07-09	=	↑	↑	↑	↓	=
	09-10	=	↑	=	=	↓	=

Source: Authors' elaboration based on GFS – IMF data and Martorano and Cornia (2012) database. Notes: the number of countries included in each region varies across the different analyses and periods. = means a variation between -1% and +1%.

In conclusion, a comparison of government reactions during the two crises, shows that different responses occurred with regards to social expenditure whereas no major differences are noticeable with respect to the cuts implemented on economic affairs which was the most vulnerable in both crises.

4. Which factors contributed to the change in social expenditure during the two crises?

We now investigate the factors that contributed to the variation in social public expenditure during the crises of the early 1980s and late 2000s. As reported above, these two crises are different and the factors affecting the changes in social spending could also have been different.

One of the most important factors is, of course, the economic environment. According to the accepted view, social expenditure should be counter–cyclical in order to be able to protect people during bad times. In high-income countries, social protection instruments – such as unemployment insurance, food stamps, social security and so on - work as a cushion during worsening economic conditions. In contrast, developing countries have underdeveloped tools of social protection. Nonetheless, there were changes in many countries over recent decades giving them the possibility of dealing with the negative social effects of the crisis better than in the past.

To increase social expenditures a policy maker needs adequate fiscal space. Both in the early 1980s and in the second phase of the 2000s crisis, high public deficits and rising debt ratios constrained policy options for a variety of reasons.

In the 1980s, the possibility of taking countervailing action against the critical economic and social conditions in developing countries was restricted by the conditionality involved in loans from international agencies, which "impose further discipline on total expenditures" (Lora and Olivera, 2006: 17). Indeed, several scholars have criticized the influence of international agencies on the decisions taken by developing countries during times of crisis[4]. The IMF's 1995 guidelines for

[4] However, there is no general consensus. Using data for 140 countries over the period 1985 – 2009, Clements et al. (2011) show that education and health grew more in countries under

adjustment (IMF, 1995) emphasized the expenditure rationalization needed in order to reach stabilization, including limits on expenditure on social benefits and the introduction of targeting among the various recommendations. In addition, countries had to reduce the size of subsidies or replace them with vouchers and to liberalize food markets. In terms of public services, it was suggested that countries should rely more on fees and charges, especially in the education and health sectors, while profitable activities could be privatized.

The adverse consequences of the 1980s crisis on poor people with the steep rise in inequality and poverty in the 1980s and 1990s fueled a "human development debate". "The UN was left to take on the role of constructive dissent. In 1985, the United Nations Children's Fund (UNICEF) began promoting the need for 'adjustment with a human face' and issued its two-volume study in 1987. By 1990, UNDP had prepared the first of its annual human development reports, setting out a more fundamental alternative to Bretton Woods orthodoxy" (Jolly, 2005: 55). All in all, there was a growing consensus about the necessity to move from "Structural Adjustments" to a "Recovery with a Human Face".

The changing environment pushed international agencies into including poverty issues directly in their programs. Thus, "the introduction of the PRGF in November 1999 was an important step in the history of the International Monetary Fund" (Oberdabernig, 2010: 22)[5]. As a result, in the first phase of the recent crisis as noted above, international agencies were more tolerant of budget deficits and less restrictive on policy choices "allowing more accommodative policy responses" (IMF, 2009: 44). For example, the IMF-supported program in Bosnia and Herzegovina aimed to avoid cuts in pensions and the Mongolia program aimed to protect social transfers (IMF, 2012a). Furthermore, some countries under IMF-supported programs expanded their social protection systems; for instance, in Costa Rica government spending on education, health and social protection rose and in Pakistan the government put priority on conditional cash transfers (IMF, 2009).

IMF supported programs. Pradhan and Swaroop (1993) find no effects of IMF and World Band programs on social spending. In contrast, Basu and Stewart (1995) report that social spending declined more in countries that embark on a SAP than in the others and Andersen et al. (1987) show that the adjustment programmes introduced by governments under the aegis of IMF included important cuts on social protection expenditures.

[5] PRGF means poverty reduction growth facility.

Also, the adverse social outcomes associated with the structural adjustment programs in the 1980s generated a growing call for equity which acquired strength following the gradual consolidation of democracy in many developing countries. Indeed, authoritarian regimes in the 1980s often disregarded the wellbeing of their populations and especially of the low income groups, who were not protected from social cuts. In contrast, the increase in people's political participation and party competition clearly affected the decisions of the policy makers. As shown by several works, during recessions democratic regimes are more cautious about cutting social spending (Kaufman and Segura-Ubiergo 2001) independently of their ideology because, it is suggested, of *"the politics of blame avoidance"* (Weaver, 1986)[6].

Moreover, it is necessary to emphasise that compared to the past developing countries benefited from greater autonomy from the recommendations of international agencies because of their low debts and accumulation of reserves (Stewart, 2012). The example of the Latin America, a region known in the past as the laboratory for the *Washington Consensus* (Birdsall et al., 2010), is illustrative. During the 1980s and 1990s, austerity produced a continuous deterioration in economic and social outcomes. Indeed, the cuts in public expenditures hampered economic growth and consequently reduced tax revenue resulting in increased fiscal deficits, producing what has been described as an 'illusory adjustment' (Easterly, 1999). From the early 2000s, Latin American countries implemented a new policy model based on a combination of growth, redistribution and macroeconomic stability (Cornia, 2012). As other regions, they were able to implement counter-cyclical policies in the recent crisis, including expanding their social protection system (Cornia and Martorano, 2012).

Finally - in contrast to the early 1980s - a Keynesian wind dominated the first phase of the recent crisis affecting the economic policy implemented by the different countries. Since market fundamentalism was believed to be the source of the crisis, neoliberal views were discredited and the implementation of Keynesian policies was considered essential to reverse the weak economic situation. In this context, social expenditures played a central role to support demand. Nonetheless, Keynesianism had a short life, partly due to the special problems of the Eurozone, and the nightmare of default began to loom in the mind of policy makers firstly in advanced economies and then, to a lesser extent, in developing countries. The growing level of debt, the threat

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[6] For Latin American countries, a similar result was reported by Brown and Hunter (1999).

of speculation from financial markets and a resurgence of the influence of orthodox (non-Keynesian) economists convinced many policy makers of the necessity to reduce deficits and limit indebtedness. At the same time, the IMF – and other international agencies – reverted to their original stance, advising that cuts in public spending were essential[7]. Although this view was quite widely challenged, it dominated policy partly because it fed into the anti-state views of conservatives and dominated the Eurozone where German influence was paramount.

We now test whether the factors discussed above contributed to changes in social expenditures during the two crises. We define social expenditures as including both social protection and public expenditure on health and education. For this purpose, a database was built including annual data for 45 and 87 countries respectively over the period 1980 – 1985 and 2007 - 2010.

Given the macro-panel nature of the data, we use the fixed effects estimation methodology. The most suitable specification for this type of dataset takes the following form:

$$\Delta\left(social_{exp_{it}}\right) = \alpha + \beta X_{it} + \eta_i + u_{it} \qquad i = 1, 2, \ldots, N;\ t = 1, 2, \ldots, T$$

where i and t denote the country and the time period respectively, η_i is the time-invariant country's fixed effect and u_{it} a joint error term for countries and time periods. The dependent variable is the variation in percentage points of the social expenditure (social protection, education and health) as share of GDP (see table 10).

[7] The IMF called for a reduction of unemployment benefits - especially in countries with a dynamic labor market – and for a tightening of the eligibility criteria for benefits on disability, sickness, etc.

Table 10. Definition, description and data sources of the variables used in regression analysis

Variable	***Description***	***Unit of Measure***	***Source***
Variation of social_exp	Variation of social expenditure (social protection + education + health)	Percentage points variation of social expenditure on GDP	Asian Development Bank database (ADB), Easterly (2001), EUROSTAT, Government Finance Statistics (GFS), IDLA database, National sources, OECD stat, World Development Indicators (WDI), World Tax Database
GDP growth rate	Growth rate of GDP per capita	Rate of growth	ERS/USDA International Macroeconomic Dataset (2011)
Public Debt	Level of Public Debt	Public Debt/ GDP	The World Economic Outlook (WEO) database 2011 and Reinhart and Rogoff (2010)
Poor countries	Developing countries	1 (developing countries) 0 (advanced economies)	Authors' compilation
IMF	Countries under an IMF-supported program	1 (IMF-supported program), 0 (otherwise)	Clements et al. (2011) and IMF's country information online database
Democracy	Index of Democracy	Index ranges between 0 and 100	Vanhanen (2011)
Right	Dummy denoting a country run by a Right party	1(Right party), 0 (all other cases)	Keefer (2010)
Keynesians	Dominance of Keynesian policies	Dummy equals 1 for the period 2007 – 2009	Authors' compilation

Source: Authors' compilation

Following the discussion in the previous section, X is a vector of explanatory variables which are grouped as follow: (i) macroeconomic conditions; (ii) external pressures; and (iii) other factors.

(i) Macroeconomic conditions. For the macroeconomic dimension of the crisis we consider two variables: the growth rate of GDP which proxies the size of the macroeconomic shocks[8]; the level of debt (as a share of GDP) proxies the country's initial fiscal conditions and its inherent vulnerability to shocks. According to the nature of social interventions such as unemployment insurance and the need to protect people against crises, social expenditures is expected to be counter –cyclical. We would therefore expect it to increase at times of crisis, and especially in the recent crisis when the need for countercyclical protective action was more widely accepted. Similarly - as discussed above - we would expect social expenditures to move in the opposite direction to the level of debt.

[8] The growth rate of GDP is only a proxy of the macroeconomic shocks which is equal to the decline in export receipts/GDP, capital inflows/GDP and remittances/GDP. The GDP growth rate is closely related to these variables but it also depends on the policy responses adopted, the amount of external financing available and other factors.

(ii) External pressures. As reported above, the international agencies had an important role during the crises analyzed in this paper. Thus, we test what happens to social spending under IMF-supported programs for the early 1980s and the late 2000s, extending the data compiled by Clements et al. (2011) for the early 1980s. In particular, the dummy variable equals 1 if a country has an IMF-supported program and 0 otherwise. Thus, we expect that the presence of an IMF agreement in the 1980s crisis will be associated with a reduction of social expenditures, while the expected sign is less clear for the later crisis due to the greater autonomy that developing countries enjoyed as compared with the past and the influence of the human development debate.

(iii) Other factors. We introduce the Vanhanen democracy index to test the impact of the spread of democracy on social expenditure. This index measures both the extent of political pluralism and citizen participation in political life. Moreover, we introduce a dummy to denote whether a country is run by a 'right-wing' government[9]. As argued above, in a democratic context (irrespective of a government's political ideology) it is in fact more difficult to cut social expenditures than other components of public expenditures. Finally, we tried to investigate whether an effective Keynesian wind dominated the first phase of the recent crisis, compared with the 1980s and the later phase of the 2000s, affecting the economic policy implemented by different countries. To proxy for this, we introduce a dummy variable that controls for the first phase of the recent crisis (2008 – 2009).

ii) Regression Results. As it can be seen in Table 11, the factors that contributed to the variation in social public expenditure during the crises of the early 1980s and the late 2000s are completely different.

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[9] Data are extracted from Keefer 2010. Right is used for "parties that are defined as conservative, Christian democratic, or right-wing" (Keefer, 2010: 7).

Table 11. Fixed effects regression results (dependent variable: percentage points variation of social expenditure/GDP): early 1980s versus late 2000s

	Early 1980s					Late 2000s				
	1	2	3	4	5	1	2	3	4	5
GDP growth rate	-0.0064**	-0.0034	-0.0032	-0.0038	-0.004	-0.0126***	-0.0138***	-0.0140***	-0.0148***	-0.0124***
	[0.003]	[0.003]	[0.002]	[0.003]	[0.003]	[0.002]	[0.001]	[0.001]	[0.001]	[0.001]
debt		-0.0023***	-0.0011	-0.0013	0.001		-0.0021**	-0.0017	-0.0008	0.0012
		[0.000]	[0.001]	[0.001]	[0.002]		[0.001]	[0.001]	[0.001]	[0.001]
debt_poor					-0.0025*					
					[0.001]					
imf			-0.1156**	-0.1194**	-0.1174**			-0.0364	-0.0475**	-0.0422*
			[0.055]	[0.055]	[0.054]			[0.023]	[0.021]	[0.023]
democracy				0.003	0.0032				0.0028	0.0054*
				[0.002]	[0.002]				[0.003]	[0.003]
right				-0.0182	-0.0212				-0.0164	-0.0142
				[0.038]	[0.039]				[0.026]	[0.029]
keynesian										0.0637***
										[0.015]
Constant	0.0342***	0.1569***	0.1188***	0.0861*	0.0564	0.0768***	0.1800***	0.1695***	0.0675	-0.1425
	[0.009]	[0.026]	[0.030]	[0.048]	[0.050]	[0.005]	[0.048]	[0.050]	[0.062]	[0.091]
Obs	171	117	117	117	117	298	295	295	286	286
R-squared	0.034	0.077	0.151	0.16	0.166	0.243	0.26	0.267	0.333	0.378
N countries	41	29	29	29	29	83	82	82	80	80

Source: Author's compilation. Notes: Robust standard errors in brackets. * significant at 10%; ** at 5%; *** at 1%

In the early 1980s, the variation in social expenditure was affected by a country's fiscal conditions, especially in the developing countries. While the level of debt/GDP becomes non significant when including other variables, the interaction between the level of debt/GDP and the dummy for non rich countries is negative and significant meaning that a high level of indebtedness pushed the developing countries to introduce social protection cuts. Economic performance had no significant impact, showing that social expenditures were not countercyclical. Also, the democracy index is not significant, probably due to the fact that the majority of countries in the developing world were run by authoritarian regimes. The regression results confirm the view that the situation in the late 2000s was different. Table 11 shows that the most important determinant of social expenditure variations then was the extent of the economic shock experienced. In particular, a worsening of economic conditions favored an expansion of the social protection systems in a counter-cyclical way. At the

same time, the level of democracy increased government's contribution to social protection independently of governments' political orientation. Although the IMF imposed less stringent conditions respect to the past, the results was not different in the late 2000s compared with the previous crisis due to the promotion of fiscal austerity especially during the last years of the recent crisis. In addition, the Keynesian dummy is positive and significant meaning that the wind lead to a more aggressive and countercyclical fiscal policy which was completely different from that adopted in the early 1980s and during the second phase of the crisis of the 2000s.

5. Conclusions

The size of the recent macroeconomic shock was greater than that of the early 1980s in terms of the change in world output. While world growth decelerated also in the early 1980s, it turned negative in 2009. It appears that the governments' reactions during the recent crisis were different compared to those implemented in the early 1980s. In the vast majority of countries, policy makers tackled the initial phase of the crisis through the implementation of fiscal stimulus packages in which an increase in social spending represented one of the main components.

The factors contributing to explain this difference in approach include the greater country autonomy compared with the past and the spread of democracy. Moreover, the negative consequences of the structural adjustment policies in the 1980s pushed policy makers to pay greater attention to human development in making their decisions. Lastly, it was evident that a Keynesian approach dominated the early phase of the recent crisis. Nonetheless, the fear of debt default in 2010 and the continuous pressures coming from international financial markets pushed many policy makers to introduce austerity packages, offsetting in part their previous actions. Since the crisis was not over at the time of writing, the net effect over the entire crisis and adjustment period may well eventually prove to have been negative in many countries.

Another major difference between the crises is that the advanced countries were most directly affected in the 2000s, and the poorest countries relatively unaffected, in complete contrast to the 1980s. This means that the poorest people are likely to have suffered less in the 2000s than they did in the 1980s. And this was assisted by social

protection that was considerably extended due to the growing acceptance of the need for Human Development – itself largely a response to the adverse conditions accompanying and following the crisis of the 1980s - and to the spread of democracy.

Unfortunately, no data are yet available after 2010. However - according to the available fiscal projections - it is evident that a growing number of countries will undergo new cuts on public expenditure and will turn more to indirect taxation. As reported by Ortiz et al. (2012; 177), "overall, an additional 32 countries are forecasted to undergo public expenditure cuts between 2011 and 2012, with the largest changes occurring in the poorest region: Sub-Saharan Africa (from 15 to 34 countries)". Moreover, about one out of three countries are trying to rationalize (i.e. cut) their social protection expenditure (Ortiz et al., 2012). These policies have been implemented or are in discussion particularly in high-income countries.

So, while the path followed by most countries during the first phase of the recent crisis limited the unpleasant consequences of the economic downturn, the return to an austerity stance increases the risk of a vicious circle dominated by an illusory fiscal adjustment and a worsening of social conditions as in the early 1980s. Cuts on social spending are detrimental for poverty and inequality; reducing the expenditures on education and health will have negative effects on future generations reducing the possibility for poor people of moving up the income distribution; and cutting investments in physical and human capital could be counterproductive both in terms of macroeconomic stabilization and long term growth.

To conclude, "pushed to extremes, austerity is bad economics, bad arithmetic, and ignores the lessons of history" (Jolly et al., 2012: 1). Policy makers have a fundamental responsibility to avoid irrational cuts on social spending and at the same time to implement the measures necessary to promote economic development and human capital formation to ensure better living conditions for the their populations.

6. References

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