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Income and Influence: Social Policy in Emerging Market Economies

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Income and Influence

Social Policy in Emerging Market Economies

NOTE: This article provides a brief synopsis of the authors' new book by the same name, which the Upjohn Institute has recently published (see p. 8 for how to order).

Social policy has only recently emerged as a significant topic of analysis and debate in the context of economic reform in developing countries. During the early days of the so-called "Washington Consensus" on economic reform, which corresponds roughly with the late 1980s and early 1990s, experts thought that macroeconomic stabilization, market liberalization, enterprise privatization, and openness to world markets would provide the underlying conditions needed to produce sustained growth— the tide that must ultimately lift all boats. But even in those countries that have most rigorously applied the Washington Consensus formula, the outcomes for working people have been decidedly mixed. Poverty, inequality, and unemployment remain widespread around the world.

As a consequence, the relationship between economic reform and social policy has emerged as a major issue for international financial institutions and the broader public policy community. The World Bank has devoted itself to "a world free of poverty," and its year 2000/2001 *World Development Report* deals with that very topic. Development economists have been engaged in research programs that seek to understand the domestic and global factors that drive changes in poverty, inequality, and unemployment. The international community's focus on social policy has arisen for several complementary reasons beyond any purely humanitarian motives. The reasons include growing worries over the political sustainability of economic reform, and fears that social problems in developing countries could "spill over" to the industrial world in the form of greater migration.

It could be argued that poverty reduction has *not* been the major objective of social policy in developing countries.

Specifically, it could be argued that poverty reduction has *not*, in fact, been the major objective of social policy in these countries, or even necessarily of the international financial institutions that are important providers of loans and advice to them. Instead, the main purpose of social safety net programs has been to help

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smooth the consumption patterns of those *formal sector* workers who feared that economic liberalization would reduce their incomes and job prospects. It is these workers who have lobbied their governments most vigilantly for social insurance, and it is their concerns that have been at the top of the domestic social policy agenda.

The pattern of social policy we observe in developing countries reflects the convergence of two major factors: the domestic political influence of formal sector workers, who provide the greatest potential roadblock to reform, and the absolute income level (GDP per capita) of the emerging market economy in question. Poor people in poor countries do not receive much in the way of social benefits because they lack political influence on the one hand, while their governments lack the income to provide them with a safety net on the other. As countries become richer, they also become more capable of providing social insurance, and the recipients of government largesse tend to be those who are politically well organized; that is, workers in the state sphere or in the major industries. Social policy is thus a function of *income and influence*.

The two most influential social policy innovations to emerge from the developing world concern pension reform and unemployment benefits.

The two programs of greatest concern to these groups, pension reform and unemployment compensation, have, not accidentally, been topics of greatest interest to the World Bank and International Monetary Fund. Pension reform—or, more precisely, privatization of the pension system—has been extolled by many public officials and academics as the magic bullet that can simultaneously stimulate capital markets, promote privatization of industry, and stabilize government budgets, while also performing its core function of providing an adequate retirement to the aging population. Unemployment compensation, once viewed as largely irrelevant as a policy instrument given the particular labor market context found in most developing countries, has become the subject of renewed interest, especially following the Asian financial crisis of 1997–1998. The two most influential social policy innovations to emerge from the developing world concern pension reform and unemployment benefits—the first in Chile, the second in Korea following upon the financial crisis.

But the challenges facing developing countries in the implementation of social policy are many and appear almost overwhelming. Beyond the fiscal weaknesses that many of these countries face, including widespread tax avoidance and capital flight, severe administrative limitations must also be confronted. Further, advancing certain policies such as pension reform requires the creation of entirely new institutions, such as independent regulatory bodies, that in turn rely on other institutions, like the rule of law, which may be very weak. In short, throughout the developing world, social policies must be introduced in the context of limited state capacity on the one hand, and rapidly rising demand for social insurance and assistance on the other.

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2003 Grant Recipients

The Payoffs to California's Community Colleges

Differences by Ethnicity, Age, and Field of Study

Duane Leigh
Washington State University
and
Andrew Gill
California State University

This study examines the relationship between community college course work and future earnings. The researchers plan to assemble data for individual California community college students that include their course work, grades, personal characteristics, and postcollege employment histories. The objective of the project is to estimate the labor market and educational payoffs to attending a California community college, differentiating payoffs by field of study, age, and ethnicity.

Reforming National Retirement Income Systems

Alicia Munnell and Steven Sass
Boston College

Munnell and Sass will research the integrated U.S. retirement income system to help the nation meet the retirement income challenge it faces in the coming decades. The United States is one of the only countries that does not view social security and private retirement plans as part of a larger national retirement income system. By reviewing the reform process to date, identifying the major options for reform in the future, and examining the experiences of five other countries, the researchers will develop the information needed to view U.S. public and private programs as a single national system, which will establish the framework for discussing various policy options.

(*continued on page 6*)