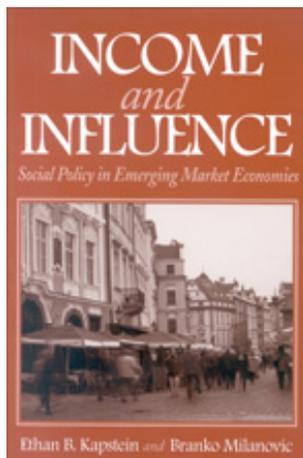

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Social Policy in Emerging Market Economies

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Income and Influence: Social Policy in Emerging Market Economies

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Social Policy in Emerging Market Economies

Designing social policies for the world's emerging market economies has become a prominent topic on the global agenda. The 1995 World Summit for Social Development pledged the international community to the goals of poverty reduction and full employment, and in recent years the international financial institutions have taken up the knitting of social safety nets as one of their core functions. Turning these ambitious pledges into concrete actions received strong impetus following the Asian financial crisis of 1997–1998. In a background note written for a meeting of the World Bank/International Monetary Fund (IMF) Development Committee at that time, the authors stated, “A system of social protection is a central ingredient of public action to help provide safeguards against adverse shocks” (World Bank/IMF Development Committee 1999).

Despite the expansive rhetoric about social policy, important questions remain about its implementation.¹ Most developing countries lack the budgetary and administrative resources to launch ambitious new programs of social protection, while the weaknesses of fiscal policy make it difficult for governments to redistribute public benefits to those at the bottom of the income distribution. Moreover, the political influence of the poor is limited. In short, issues of governance and political economy loom large in the design and execution of social safety nets.

We argue in this book that economic liberalization, particularly policies associated with greater openness, have increased the demand for social policy in emerging market economies. This is *not*, however, because the process of reform has produced some neat, “once and for all” division of winners and losers, such that social policy can be cleanly targeted at the latter by means of lump-sum compensation payments. That model of economic adjustment is rarely found outside academic journal articles. In practice, who wins and who loses from these policies varies not only across countries but also over time. In the middle-income emerging market economies which provide our focal point—mainly those found in Latin America, East Asia, and Central and Eastern

Europe—we would argue that the winners and the losers may in fact be one and the same group, depending on the time horizon that is adopted.

Specifically, we argue that for those skilled and semiskilled workers who are found in the upper deciles and who work in the formal sector, economic reform brings with it a serious downside, at least over the medium term, as restructuring and market opening lead to job displacement, unemployment, and greater economic insecurity. These workers are thus particularly vulnerable to the changes wrought by economic liberalization, including shifts in the terms of trade, and they have the greatest fear of falling into the lower economic classes. This group may enjoy, relatively speaking, the greatest rewards from economic reform in the long run, but they also face the greatest risks of downward mobility more immediately. As a consequence, these are the workers who have lobbied most strongly for social insurance programs, and who have been the main beneficiaries of social policy reform. Indeed, the concerns of these groups have resonated both domestically and internationally. In short, it is the relatively privileged income groups in middle-income countries that have won the lion's share of the social policy benefit; the poor in poor countries have seen little by way of social insurance or assistance, in part because they are politically weak, and in part because the countries where they live have extremely limited budgets. This argument is summarized in Table 1.1.

The significance of social policy has likely risen with the spread of democracy as well. Domestically, the consequences of economic reform have been challenged at the polls, as well as outside the electoral system in the form of organized opposition, such as strikes and riots. Social policy schemes have thus been introduced as a way of winning political support from the most affected groups; they have not, as a general rule, been targeted at the poor. Internationally, the “globalization” of many of the problems associated with the absence of effective social policies, including increased demand for migration, has led officials in the North and in international organizations to believe that market-oriented reforms must be complemented by attention to social safety nets. For example, Juan Somavia, the Director General of the International Labor Organization (ILO), has warned that “the global economy is not creating enough jobs,” inevitably leading to greater pressures for migration. Greater attention to “socio-economic security,” he argues, and to improved coordination between social and economic policies, would make for a more success-

Table 1.1 Social Transfers, by Income and Influence

Relative income level within country	Country's GDP per capita level	
	Low	Medium or high
The poor	Nothing	Some assistance
The middle class	Very limited social transfers (primary education)	Extensive social protection (education; health; pensions; family benefits; unemployment)
The rich	Some social transfers (pensions; education)	Extensive social protection (education; health; pensions; family benefits; unemployment)

ful reform strategy (Somavia 2002). As economist Dani Rodrik has written, social insurance “cushions the blow of liberalization among those most severely affected, it helps maintain the legitimacy of these reforms, and it averts backlashes against the distributional and social consequences of integration into the world economy” (Rodrik 1999).

Despite this increase in demand for social policy, developing countries and transition economies confront a variety of special challenges in designing and implementing programs that are effective and efficient. The World Bank (2001) reminds us that, “[t]he state may well be the best agent to provide insurance, but lacks the necessary institutional strength, financial resources, or management capacity.” Governments will also face difficult political economy issues in structuring these programs, given that “[t]he political support to allocate resources may also be lacking, since it requires getting the rich to support a program that does not benefit them.” In sum, the emerging market economies are subject to a particular set of constraints in meeting the needs of their uneducated, unemployed, poor, aged, and sick populations.

This chapter situates our argument about the political economy of social policy within the context of the broader literature on the welfare state. While the European welfare state (and its North American variant) has been the subject of a major research program in social science for many years, social policy has only recently joined the academic pan-

theon as a major topic for students of economic development and reform (for overviews see Graham 1994; Chu and Gupta 1998; and Ghai 2000). These programs—including pensions, unemployment compensation, and other income transfers—did not figure prominently in the early iterations of the so-called “Washington Consensus” model of reform, which focused on price liberalization, macroeconomic stabilization, and privatization of state enterprises. In part, this was due to a widespread belief among economists that “strong medicine” would produce sustained growth, resulting in high rates of employment and wealth creation, and making the focus on social policy largely unnecessary (Williamson 1994; Rodrik 1996; Kapstein 1997). And in certain regions, especially East Asia, it appeared to many observers that specific cultural values and deep wells of social capital made the formation of welfare state institutions irrelevant if not counterproductive.

Clearly, two recent events, coupled with the earlier experience of the Latin American debt crisis, have shattered that optimistic view: the transition of former Soviet bloc economies from communism to a market orientation, and the Asian financial crisis of 1997–1998. The economic transition, which has plunged millions into poverty and has even been associated with shortened life spans in several countries, including Russia, has been labeled “a cruel process” by the United Nations (UNDP 1999), while the Asian crisis is said to have produced, in the words of ILO’s Eddy Lee, “widespread social distress” (Lee 1998).

The magnitude of these crises naturally provoked immediate responses on the part of public officials and nongovernmental organizations, and it also caused academics to reconsider some of their theories of economic development and reform. But did these shocks *cause* social policy to rise on the public agenda of developing countries and international institutions? Or were other, deeper forces at work that spurred a growing demand for social safety nets? These questions lead us to consider some of the alternative theories of social policy development.

THEORIES OF SOCIAL POLICY AND THE WELFARE STATE

Despite the apparent correlation between recent crises and the renewed attention being given social policy, there are in fact at least six

different causal theories, not necessarily mutually incompatible, as to why social issues have come to occupy such a leading place in contemporary discussions of economic development and policy reform. It is important to emphasize that disagreements remain about the specific causal mechanisms that give rise to public demand for government-provided social schemes, as well as over the incidence or distributive consequences of such spending. In part, these disagreements reflect data limitations and a lack of hypothesis testing, but strongly held normative views have also shaped this research program. The main views are as follows.

First, some scholars have suggested that the process of economic reform has had dramatic distributive consequences within societies, and that the “losers” have demanded compensation in the form of welfare state policies as the price for their (tacit, if not active) political support. In this view, income transfers are the necessary domestic complement to policies of market liberalization, and in their absence a backlash against reform will occur. Social policy is thus part of a grand bargain between national governments and society. (For a review of the literature, see Kapstein 2000.)

An associated argument holds that a larger welfare state is necessarily associated with increasing economic openness. The underlying hypothesis here is that as countries open themselves to the world economy, their industries and workers face terms-of-trade risks against which only governments can provide insurance. This is particularly the case for small economies. Confronted by increasing economic volatility, the workforce demands social safety nets as the *quid pro quo* for a more open trade policy. Further, to the extent that openness promotes greater income inequality, as many researchers now agree that it does (while still debating its exact impact), voters may demand redistributive social schemes as a way of redressing the balance. Supporting these theoretical arguments is the empirical finding that open economies tend to have bigger governments (Rodrik 1997).

A second perspective is fundamentally humanitarian and cosmopolitan, focusing on the consequences of the economic shocks of recent decades for the lowest income quantiles, especially in developing countries. These shocks led to sharp increases in poverty and unemployment, overwhelming existing insurance schemes, both formal and informal. A host of social problems are associated with these economic problems,

including rising crime and, in some regions (notably the transition economies), a dramatic worsening of public health. Captured on global television, these humanitarian crises have mobilized nongovernmental organizations, such as Cooperative for Assistance and Relief Everywhere and Catholic Relief Services, to provide emergency assistance, and to act as lobbyists for their cause. In response to growing public pressures, industrial world governments and international financial institutions have come to recognize their responsibility in the face of humanitarian crises; in some countries, the provision of aid to those in need has even been deemed a worthy new task for post-Cold War militaries. In short, this view asserts that the recent attention paid to social policy arises out of a concern for the well-being of citizens not only exposed to the ravages of natural disasters of various kinds, but who have been hurt by economic reform and structural adjustment as well (Lee 1998; Lumsdaine 1993).

A third view also emphasizes the role of international institutions in managing the process of globalization, but this perspective is more technocratic. In its benign variant, these institutions are portrayed as having learned from history about what makes for successful adjustment and reform programs, and have recognized the need to incorporate social policy into this process (Finnemore 1996). In its malign form, these institutions are viewed as tying their conditional lending programs to harsh austerity programs that throw workers into the street. A minimal social safety net is offered to these workers out of a *realpolitik* calculation on the part of “global capitalism,” in which these institutions, of course, serve as mere lackeys.

A fourth perspective focuses on democratization and the demand of newly empowered voters for greater social spending (Brown and Hunter 1999; Birdsall and Haggard 2000). A growing body of political economy literature hypothesizes that democracies are likely to promote welfare state institutions for two reasons. The first is due to the preferences of the so-called median or middle-income voter, who may not have the economic means to protect herself against possible downturns in her fortunes, and will seek to promote public sector programs for unemployment insurance, health care, and pensions by taxing the rich. A related theory focuses on the role of organized interest groups, such as labor unions and retired persons, and the political voice they gain in the process of electoral and policy contestation. Both of these approaches

lead to the expectation that as emerging market economies democratize and become older, political pressures for the further development of social insurance programs will increase.

A fifth theory, prominent in the welfare state literature, sees the rise in social policy as inextricably linked to the process of modernization and industrialization; in this view, the developing countries are largely mimicking a process earlier experienced by today's advanced economies (Lindert 1996). The causal argument is that, as these processes unfold, workers leave behind the family and kinship networks that previously helped to maintain them during hard times in the rural sector. In the absence of these informal safety nets, the state acts to provide the support system, and in so doing, the government acts on behalf of the modernization process and of industrial capital. These economic factors, when combined with growing electoral contestation, appear to have played an important role in the evolution of the European welfare state; they seem to have been less influential in shaping the East Asian social contract.

In a related vein, rising incomes may also lead to a greater demand for social insurance. In this model, welfare programs may be conceptualized as a luxury good that people buy as they become wealthier. Lindert (2000) has provided some support for these arguments in his econometric research, observing that the richer the country, the greater the share of its GDP spent on social insurance. Further, he observes that public sector social spending is a fairly recent phenomenon, with particularly rapid growth since the end of World War II from a relatively feeble 19th century base. Prior to that time, it was the Church and other charitable organizations that took the lead in welfare provision.

Finally, in the economist's parsimonious view, social policy simply reflects the failure of markets to provide people with the assistance and insurance they may wish to buy in order to meet the risks with which they are presented. These market failures could be due, for example, to information, adverse selection, or covariance problems. For whatever reason, the private sector refuses to sell the insurance that is demanded, and the government steps in to provide it.

Let us explore each of these theories in turn.

The first perspective is closest to the political economy approach we adopt in this book. It emphasizes the distributive nature of economic change, including market liberalization. Our research indicates that eco-

conomic reform, particularly policies associated with trade and financial opening, has created a demand for transfers to those groups most vulnerable to fluctuations in their income stream, and not necessarily to those in poverty. In this regard we emphasize that the two social policies that have received the most attention from the international community, pension reform and unemployment compensation, are the programs of greatest concern to this “striving class” of workers.

The second view, focusing on humanitarian concerns, posits that social policy is mainly designed to counteract the effects of poverty and extreme vulnerability. We do not believe that there is much evidence to support that contention in developing countries. As the IMF economists have written, the weak fiscal features of developing countries, including widespread tax evasion, “cast doubt on the ability of tax policy to redistribute income” (Chu, Davoodi, and Gupta 2000, p. 3). Nor have the international institutions fared much better in targeting their aid programs. There is thus a sharp distinction to be drawn between the emergency relief programs provided to political and economic refugees or victims of natural disasters, and “the poor” as an income group. While humanitarian motives may explain relief efforts, we do not see much of a spillover effect in the form of permanent redistributive measures to help those in the lowest-income quantiles.

The third perspective, emphasizing the role of international institutions, brings with it significant insights. Most historical analyses of the welfare state have emphasized the role of national actors and institutions in policy development. Less attention has been paid to international political, economic, and, perhaps most important, ideational pressures (but for a partial exception, see Kapstein 1999; Deacon 1997; and Gain 2000). We agree that this represents an important gap in the literature, and it is one that we address in this book.

To flag our argument, we contend that international institutions may promote social policies *directly* by financing, through their lending schemes, insurance schemes in particular countries, and *indirectly* by transmitting ideas about what constitutes sustainable economic policies for growth. As we will show, agencies like the IMF and the World Bank have negotiated social policy reforms as part of the conditionality agreements struck with developing countries, and the role of these policies has apparently grown over time, reflecting a change or evolution in views about their importance.

The fourth position, linking democracy and social policy, also has a growing body of evidence to support it, and it may be viewed as complementary to the position we emphasize. After all, if voters and organized interest groups can influence policy choice, it is largely because of the exigencies—the “pushing and pulling”—associated with democratic politics. But we would add as a caveat the reminder that many different regime types, including military governments, dictatorships, and communist regimes, have also engaged in social policy reform and the provision of universal social benefits. That historical fact suggests that the literature on modernization and industrialization, as stated in the fifth view of the welfare state, also contains some critical insights into the emergence of social policy around the world.

Finally, the economic perspective highlights market failure and the demand for state-provided welfare services. By this logic, it may be argued that, as a general rule, individuals should cover risks that are of an idiosyncratic nature, or those associated with their particular behavior. In contrast, risks that are common to large groups of citizens usually cannot be financed out of an individual’s pocket, and instead must be pooled more widely. Where the risk is to an entire nation or to a large segment of it, the state may be expected to provide the requisite insurance in its entirety.

In reality, of course, we find significant deviations from these general principles. To take an obvious case, it could be argued that old age is the sort of “risk” that every worker has an entire lifetime for which to prepare, and thus should motivate workers to save for it out of their annual earnings. Yet almost every industrial country provides its aging population with a public pension and medical insurance of some sort. Similarly, it is not obvious why many governments are in the business of providing health care insurance to their citizens, since private firms could theoretically sell coverage to beneficiaries; but here too we find that the industrial states have come to occupy a large role in subsidizing medical treatment, and in some countries, like the United Kingdom, medicine has been largely withdrawn from the private sector and instead has been “socialized” (Barr 1993).

The specific incidence of social programs suggests that more than economic calculations of efficiency or market failure are at work when such policies are devised and implemented. Exploring the political conditions under which the welfare state emerged has thus occupied a gen-

eration of historians, political scientists, and sociologists. As of yet, their research has failed to produce a consensus or unified field theory with respect to the causal forces that have shaped the formation and subsequent development of social policy. Indeed, to the extent that there is a consensus, it perhaps revolves around the path-dependent and contingent nature of social insurance provision, and it is the differences among welfare states as much as their similarity that has attracted a good deal of academic attention.

The limited explanatory power associated with each broad theoretical perspective becomes clear as soon as they are applied to specific country case studies. The democracy variable, for example, is problematic in that many welfare states reached their heyday under communist or autocratic regimes. And in Western Europe it may be argued that it was not so much the advance of democracy as the threat of socialism and communism that launched the welfare state in Bismarck's Germany and fostered its later refinement and growth in the post-World War I and World War II environments (Kapstein 1999).

If disagreements persist about the precise causal variables that have shaped the welfare state, there are also differing views over the typology of such states. Esping-Andersen (1990), for example, has spoken of three welfare state regimes: liberal (Anglo-Saxon), corporatist (continental European), and social democratic (Scandinavian). None of these, however, encompass what might be termed "total" welfare regimes (as were the communist states), or the paternalistic models associated with many autocracies. Further, some scholars and public officials have suggested that there may be a particularly Asian approach to the welfare state, with its negative view of open-ended cash transfers and an emphasis on kinship networks (Birdsall and Haggard 2000). In addition, the social safety net in the Middle East also has its distinctive features, focusing on direct subsidies and universal provision of health and education (Tzanatos and Kaur 2002). Esping-Andersen's classification is thus, at best, only fragmentary, and at worst, Euro-centric and parochial.

Why have societies adopted such differing approaches to social policy? Esping-Andersen focuses on three factors: "the nature of class mobilization (especially of the working class); class-political coalition structures; and the historical legacy of regime institutionalization." Operationalizing these factors, however, presents serious problems for

researchers, especially for those who seek to engage in econometric testing of propositions. The absolute size of unions, for example, may mask their much greater political power (that is likely the case for such countries as France), while voting patterns of the middle class vary over time and across countries. In short, finding proxy measures that could yield statistically significant results remains a challenge for welfare state scholars, and that problem is, of course, greatly magnified when one deals with the developing world.

The approach we adopt here is that social policy implementation largely represents a political response by governments as they attempt to win support for their project of economic reform. The possibility of a backlash against market liberalization and globalization suggests the need to bargain with and find payoffs for those most directly affected by economic and technological change. In the absence of such compensation, these groups will have incentives to lobby against and possibly stop the liberalization policies that are being advanced.

Yet the governments of emerging market economies that find it necessary to invest in social safety nets are also confronted by its costs. At a time of severe fiscal restraint, establishing such programs may imply sharp trade-offs with other projects that also have as their objective the buying off of politically important groups; for example, a trade-off between increases in defense and social spending might have to be made. Balancing interests, of course, is the stuff of politics, and there is no reason why social policy should be exempted from that process. But this emphasis on politics indicates why it is that groups without much in the way of political voice—notably the poor—have failed to enjoy much material benefit from the renewed attention being given to social policy around the world.

THE SOCIAL SECTOR IN EMERGING MARKET ECONOMIES

As with the industrial economies, emerging market economies are characterized by great diversity when it comes to the provision of social transfers (see Table 1.2). In addition to the *formal* (that is, government)

Table 1.2 Social Insurance and Social Assistance Cash Spending as Percentage of GDP in Selected Emerging Market and Developed Economies

Country	1985	1988	1990	1995	1997–98
Argentina	5.8	4.4	4.8	8.5	7.7
Brazil	5.9	6.3	8.8	10.3	11.0
Chile	11.8	7.6	7.2	6.8	7.6
Malaysia	1.0	1.1	1.1	1.4	1.0
South Korea	1.0	1.1	1.5	1.5	2.0
Thailand	0.6	0.6	0.5	0.6	0.8
Poland	8.6	8.8	11.0	20.5	19.5
Hungary	12.5	15.1	14.9	16.7	13.2
United Kingdom	12.4	12.4	12.0	15.0	13.3
Germany	13.1	12.6	12.3	16.9	17.0
United States	6.9	6.1	5.8	6.3	5.7

SOURCE: Calculated from IMF, *Government Financial Statistics Yearbook*, various issues, and World Bank DECPO (B. Milanovic) database.

provision of social insurance and assistance shown in the table, there are also *informal* transfers provided by households or extended kinship networks.

The real issue at stake with respect to emerging market economies concerns not so much the existence of social schemes as their effective coverage. With most of the formal programs, coverage is often limited to civil servants or employees of large enterprises and does not reach the lowest income groups. These privileged individuals are “provided with pension schemes, health insurance, and sometimes even unemployment benefits. However, most of the population remains excluded from these schemes” (Decron 1999, p. 1).

An analysis of the demography of formal social provision is suggestive of domestic politics rather than of the economic situation facing the most vulnerable citizens; if social policy is targeted in many countries, it is toward the middle and upper classes. As Carol Graham has written, “[f]ew governments have immediate political incentives for helping the economically poor, who also tend to be poor with respect to

political voice” (Graham 1994, p. 8). Further, she and others have also pointed out that economic shocks (like a financial crisis) may not, at least over the short run, have much of a material effect on those in the lowest income deciles (generally the rural poor) as compared to other groups (e.g., industrial workers who lack unemployment insurance), and that these better-organized workers may win from the government and international institutions social policies, like income transfers, that become part of postcrisis adjustment packages.

One of the distinguishing features of most emerging market economies is the heavy reliance that individuals place on informal insurance mechanisms. This informal insurance, provided at the family and community levels, includes “reciprocal need-based gift exchange, trading physical assets, and the use of risk-reducing production techniques” (Morduch 1998, p. 1). Such insurance can be relatively sophisticated, and some forms of it may be in place before crises arise, while others are worked out in the context of particular contingencies. Indeed, owing to the extent and diversity of informal schemes, some observers (Kwon 1997) have asserted that the implementation of government-sponsored social policies will inevitably lead to the disruption—if not displacement—of these fairly dependable grassroots approaches, with a number of unpleasant consequences, including the diminution of community and kinship networks and the extension of (often corrupt) state power.

Yet, as Morduch (1998, p. 8) has argued in a useful overview of the literature, “the optimism” surrounding that view of informal safety nets “has now been tempered.” Empirical studies, undertaken in sub-Saharan Africa and elsewhere (including Southeast Asia following the financial crisis of 1997–1998; see Lee 1998), suggest that the coverage provided by these informal networks to the poor is less extensive and less effective than previously believed. Informal insurance may be costly to acquire; it appears “to be particularly fragile when needed most”; and it is “weak against repeated shocks” (Morduch 1998, p. 10). Further, these informal approaches may favor certain ethnic groups, and they assist men to a greater degree than they do women (World Bank 2001, p. 145).

For these reasons, properly designed government programs, which limit the “crowding-out” of private or kinship insurance, have a useful role to play in social insurance and emergency assistance. Public agencies and policies, for example, can help to bolster credit markets, as is the

case with student loan guarantees in the United States. The government-provided guarantee does not displace local financial institutions, and it contributes to better economic performance by assisting able students to attain the level of education they seek. This is the sort of policy initiative that arguably contributes to economic efficiency while strengthening family-based support structures.

As Table 1.2 reveals, government spending on social safety nets varies enormously across the emerging market economies. In Asian countries, the amounts are small and although there were some increases in the wake of the crisis, spending there is still far below the levels in Latin America and Eastern Europe. By the end of the 1990s, the southern cone countries in Latin America (Argentina, Brazil, and Chile) were spending between 8 and 11 percent of GDP on social transfers, Poland and Hungary 20 and 13 percent, respectively, and Asian countries only between 1 and 2 percent of GDP. Compare that with West European spending that often exceeds 15 percent and sometimes reaches 20 percent of GDP. Although it is difficult to speak of a trend, because of both the noise in the data and a small sample of countries shown here, on balance, the spending as a share of GDP seems to be increasing. Economic reform, democratization, and demographic change might have been the key drivers behind that development

The extent and effective coverage of social programs remains modest in most developing countries. Cash transfers often amount to no more than a pittance and sometimes go unpaid for long periods of time, as has been the case in Russia. Of course, cash transfers are not the only social programs. If social safety nets in emerging markets can be thought of as “those instruments aimed at mitigating possible adverse effects of reform measures,” it can be seen that many different schemes may be included, including food subsidies, health insurance, public works projects, and educational grants (Chu and Gupta 1998, p. 7). The specific forms of insurance often differ among countries and regions; the former Communist countries still provide a wide spectrum of social programs (if not very effectively), while African countries have extremely limited formal support systems, most of which are targeted at state-sphere workers. Latin American countries often have well-developed pension systems, especially for those in the formal economy, but the effectiveness of that system has diminished in the face of that region’s frequent financial shocks. Public pension schemes, for example, are extremely fragile in a

large number of countries and have been a major focus of reform efforts, with Chile leading the way. Yet, the experience with the private pension funds has been much less satisfactory than was originally expected (see Mesa-Lago 2002).

But the articulation and reform of government-sponsored social programs faces a number of political and economic challenges. From an economic perspective, “comparative cost data and cost–benefit analyses are generally not available to help policymakers choose from different types of risk management interventions” (World Bank 2001, p. 146). From a political standpoint, most public officials in emerging market economies probably would not view the use of government authority to extract tax revenues from those in the upper-income quantiles on behalf of those in the lower income quantiles as a winning political strategy.

These facts are suggestive of the political economy issues associated with social policy design and implementation. In seeking to expand the formal safety net in developing countries, governments and international institutions should, as a normative rule, reach out to individuals in the lower-income groups. This requires that the poor be better “targeted” as program recipients. But as Kanbur (1998) has pointed out, targeting brings with it three associated problems, each of which poses difficult problems for even the best-intentioned public officials.

First, for many cash or in-kind transfers, targeting implies that benefits will be removed when and if the recipient reaches a given income level. That means that the recipient faces a potential disincentive for acquiring greater income and “the trade off between incentive and targeting effects will have to be managed” (Kanbur 1998, p. 23). In other words, since he faces a 100 percent marginal tax on his income, he may fall prey to what is called a “poverty trap” and then, in the longer run, to welfare dependency.

Second, targeting may require a substantial addition in administrative capacity and thus in program costs. To the extent that scarce funds become devoted to program managers as opposed to recipients, social policies in effect become jobs programs for the middle class (and international civil servants!). Arguably this has been the case in European welfare states.

Finally, in Gelbach and Pritchett’s (1997) pithy phrase, it may be the case that “more for the poor is less for the poor.” This is because the upper-income quantiles can be expected to balk at paying for programs that do

not deliver any benefits to them and refuse to endorse such measures. For this reason of political economy, universal programs may in fact provide more benefits to the poor than those that are explicitly targeted.

Some of these problems may be overcome by the use of self-targeting mechanisms, as in workfare programs where workers are provided low-paying jobs, or by subsidizing specific, often inferior, products which are normally consumed by the poor. The latter is the idea that lies behind the subsidization of staple products (bread, rice, cooking oil), which is commonly done in the Middle East, central Asia, North Africa, and a number of African countries. Despite a rather paternalistic element present in such programs, they have often been very popular with the poor, and despite assurances by the international financial organizations that the leakages are large, and that the programs' removal or "rationalization" would not too adversely affect the poor, the reality has often been different. Removal of subsidies has led to violent reactions and riots, from Algeria to Zambia.

Given these domestic administrative and political economy difficulties, it is not surprising to find external assistance playing such a large role in the funding and reform of social safety net programs in the developing world. According to a study prepared by the United Nations (referred to in Vivian 1994), bilateral and multilateral aid programs in Africa and Latin America have borne a large share of domestic social sector costs. The World Bank, the IMF, the European Union, and other donors have also contributed significantly in both financial and intellectual terms to social policy reform in the post communist transition economies. Further, some safety net programs have, it appears, been *imposed* by international agencies as conditions for receiving assistance during emergencies. While there may be legitimate reasons for international donors to advocate the creation of social assistance and insurance schemes that target the poor, Jessica Vivian has rightly argued that "External funding for safety net programs raises questions of autonomy and sustainability" (Vivian 1994, p. 12), particularly so since that assistance comes in the form of loans that need to be repaid. As of this writing (July 2002), the World Bank is about to disburse some \$100 million to Argentina for critical social emergency programs. Yet that money, while highly needed now, will have to be repaid in five or seven years.

We should be cautious, however, not to exaggerate the role of the international financial institutions or bilateral aid agencies; most coun-

tries, even in the developing world, depend mainly on domestic budgetary resources for carrying out their policies. Nor should we imagine that social development is a disaster everywhere. As Dharam Ghai has pointed out, there are several important cases in which countries have managed “to reach a level of social development distinctly superior to that which would be expected on the basis of their level of per capita income.” (Ghai 2000, p. 1). How countries such as Chile, Costa Rica, and Sri Lanka, or regions within countries, such as the Indian state of Kerala, have achieved that level of performance is a puzzle that needs some explanation, and drawing appropriate lessons from these experiences should be high on the international policy agenda.

According to Ghai, three factors “have been crucial” to policy success, and it is useful to evoke them here:

First, all these countries were characterized by a political leadership that was strongly committed to the provision of health and educational services to the entire population. Second, in all cases the state played a central role in extending a minimum core of services throughout the country. Thus the administrative capacity of the state and the infrastructure necessary to reach all parts of the country and the major segments of the population were vital to their success. Thirdly, the composition of public social expenditure—emphasizing literacy, basic education, and primary health care—rather than its relative size, accounts for their social achievements. (Ghai 2000, p. 3)

What these points suggest is that universal social programs, like spending on health care and education, are more likely to win the support of elites in the upper-income brackets than are targeted programs that emphasize cash transfers and subsidies. Indeed, this point was made by Clive Bell as early as 1974, in his contribution to the seminal work *Redistribution with Growth* (see Chenery 1974, pp. 53–72). Bell wrote that “certain kinds of investments in the poor, such as education and health, may lead to long term pay-offs to the rich, who need productive workers to operate their capital” (Bell 1974, p. 54).

But even with respect to education, the political economy dynamics present a troubling aspect in most of the emerging market countries. While the rich may support universal basic education, access by the poor to secondary and tertiary schooling is much more limited. Across the developing world as a whole, the poorest fifth of the population

receives only 3 percent of public expenditure on tertiary education, while the richest fifth receives almost 70 percent. In short, a disproportionate share of spending on higher education goes to those in the upper-income deciles, limiting education's power as a vehicle for social mobility (Landa and Kapstein 2001, p. 142).

WHAT ARE THE OPTIONS?

We have characterized the emerging market economies as having an increasing demand for social policies but an unsatisfactory supply due to limited administrative capacity, fiscal constraints, and impediments posed by political economy considerations. These problems necessarily limit the extent and effectiveness of government-sponsored social schemes. Although growing, bilateral and multilateral transfers in support of social insurance still represent only a small share of GNP for most countries. At the same time, family and kinship networks, which need strengthening to cope with severe shocks, as occurred during the Latin American debt crisis or the Asian financial crisis, may in fact be threatened by efforts to increase the state's reach in this domain. Thus, the one system that actually works, even if only partially and most imperfectly, could be imperiled by the well-meaning efforts now on the global policy agenda.

That portrays a grim picture. But it does suggest that one ought to proceed cautiously with social policy implementation and reform. What are the policies now under consideration? Among those policies, which are most likely to prove useful to those who have greatest need for social services? We discuss these questions in the remaining chapters.

Note

1. In this book we define social policy in terms of social assistance and social insurance programs, focusing on unemployment insurance, pension schemes, and other income transfers. While we also discuss spending on education and health, and believe that public policies in these areas are critical to the life prospects of those in the lower-income quantiles, these topics merit and have received separate treatment elsewhere; see, for example, United Nations Development Program (1999).