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Social development in Latin America?

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Latin America is notorious for its attempts at economic development resulting in inequality and unsustainable growth. But the good news is that this pattern may have changed. Inequality has been falling since 2000 while positive and sustained growth rates, along with increasing HDIs, have become the norm. In this section we document and appraise the common past and trends observed in the region, and examine in more detail the Brazilian experience, which has drawn some attention, to discern a possible new 'social developmental' model in the making as well as some of the (still vast) challenges ahead.

Common past

For most of the past 50 years, Latin America experienced erratic GDP growth rates, accompanied by high levels of income inequality, which have ranked the region among the most unequal in the world.[2]

During the 1960s and 70s, development projects based on import substitution industrialization (ISI) were tried, generally led by authoritarian governments and funded by external indebtedness. These were years of high growth,[3] but also of soaring inequalities, associated with intense processes of industrialization and urbanization, which, in contrast to other development experiences, were not counterbalanced by compensatory welfare states. By the middle of the 1980s, the high growth trajectory, especially because of its dependence on external finance and the reversal of international circumstances, ended in the debt crises that dragged the region's economies into long recessions (and eventually stimulated re-democratization).[4] The social effects of these economic downturns were severe: high unemployment, increased levels of poverty and inequality and stagnating social indicators.

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[2] Thus, even in recent times, the Gini coefficient for the region (0.53 in the mid 2000s) is 18% higher than in sub-Saharan Africa, 36% above East Asia and the Pacific, and 65% higher than high income countries. See López-Calva and Lustig 2010. Ten of the fifteen most unequal countries in the world are in Latin America (UNDP, 2010).

[3] Regional GDP growth rates in the 1960s and 70s were above 5%.

[4] The average GDP growth in the 1980s was around 1.5%.

State-led development projects have a long history in the region, and gained momentum after World War II. A common result of these early development experiments is that the socioeconomic structure remained highly concentrated - of property rights over land and other natural resources, and access to opportunities for expansion of personal and group capabilities, such as education, health, sanitation and other public services, housing, formal jobs, occupational mobility, social protection and economic security. In virtue of political economy factors, such as the disproportionate responsiveness of the basic institutions that regulate the distribution of social and economic entitlements to the entrenched elite, the development projects have not substantially improved the well being of the population at large, and have even diverted resources collected through general taxation to subsidize economic projects mainly serving the interests of already strong economic groups. Typically, the region put in place an undeveloped welfare state, offering incomplete protection (almost exclusively to workers in the formal labor market) and low opportunities for expansion of capabilities, to compensate for a highly dysfunctional economic model, socially speaking.

The eighties, and to some extent the nineties, were known as the 'lost decade'. But while this was a temporary curse to the region, it also opened an extraordinary opportunity for change that was later to be seized by many countries. The debt crises did more than marking the end of the old-style state-led ISI models. They also were an important factor boosting the re-democratization of the region. The failure of the ISI project contributed to delegitimize the incumbent political elites in the eyes of the middle classes and gave the chance for other aspirations to come to the political fore. Typically, the democratization movements of the 1980s-1990s were accompanied by the drafting of new constitutions, which then restored the prominence of equal civil and political rights, and introduced social rights. However, many countries were strongly constrained by external restrictions, inflation, and recession, and were compelled to undertake fiscal adjustments that then further reduced their ability to mount compensatory welfare systems. Among the measures undertaken were Washington Consensus-style market-oriented reforms. As a result, poverty and inequality increased,[5]

[5] Ferranti et al. (2003) estimated the separate effects on inequality of different reforms, such as those leading to price stabilization (positive), privatization of public facilities (mixed: positive where the effect of expansion of service coverage to the poor dominated and negative where price effects offset the coverage effect), and trade liberalization connected with faster adoption of skill-biased technologies (negative, in association with increased wage disparity). But where the education system matched the increased demand for education (Chile and Mexico), the overall effect was positive.

a situation that did not begin to shift until the new century. It nonetheless must be said that the region and every country in it experienced increases in the HDI even when the per capita GDP was declining, the most notable achievement being life expectancies.[6] This may be a reflection of the expansion of public services that occurred in the period, indicating that public moneys under democratic control were reoriented to expand capabilities in general.

The eighties and nineties also saw Latin America as a sort of laboratory for experimentation with new social technologies, such as low-budget and carefully targeted conditional cash transfer programs (the CCTs) and, in general, management and adjustment of social policies to target the very poor. In some cases, these policies were introduced as part of IMF bailout packages; in other cases they were undertaken 'voluntarily' to fit in the new paradigm of 'good government practices' designed for indebted countries. In any case, the move was in the direction of internal adjustment of a compressed social budget under the new circumstances of fiscal austerity.

It is however interesting to note the ways in which these new social policies have interacted with internal political processes to generate variegated policy responses and effectiveness. Under the common circumstances of economic downturn and re-democratization, retrenchment of previous welfare state structures (by and large of the corporative social security style) varied a lot: adjustment of social priorities along the IMF lines was easier in countries whose level of social expenditures was low than it was in countries with a tradition of relatively high levels, the conspicuous examples being Chile (a low spender) and Uruguay (a high spender), reflecting the well documented path dependency of welfare reforms.[7] Also, the intrinsic possibilities and limitations of such policies are noteworthy. Among the virtues of the CCTs are their low budgets, typically less than .5% of GDP, and high short-range effectiveness in terms of alleviating extreme poverty and reducing income inequality among the poor. Among the drawbacks are precisely the low value of the (provisional) benefits and inattention to the defective labor market dynamics[8] and social services that predominate in the region. Although the CCTs are generally oriented to provide social protection for rural

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[6] From 1980 to 2000, the HDI progressed steadily from 0.641 to 0.724, and life expectancy from 64 to 72 years (UNDP).

[7] See R. R. Kauffman & S. Haggard (2008).

[8] Around 50% of the workers in the region are in the informal market (SEDLAC), lacking social and work protection and often earning wages below the minimum level, in contrast to 16% autonomous workers in the European Union (OECD).

subsistence farmers, informal workers and the unemployed, and to break the vicious circle of poverty by imposing enrollment of the beneficiaries' children in schools, they hardly liberate people from their entrapment in poverty: the benefits do not raise people above the poverty line (often, not even above the extreme poverty line), the schools are often substandard, and the labor markets are still dysfunctional.[9] Also there is internal variation as to styles and extent of cash transfers and public debates related to their future. In this respect, the cases of Uruguay (rights-based approach to transfers) and Peru (short-term market-oriented transfers) perhaps represent two diverging trends.

Common trends and Brazil

Since the beginning of the twenty-first century, positive growth rates have been consistently achieved.[10] These have been higher in countries that have benefited most from the global commodity boom. In addition, poverty and inequality have been decreasing steadily,[11] more intensely in countries governed by left-of-center parties/coalitions.[12] We estimate very strong negative correlations between the Gini index and the per capita GDP, and between the Gini index and the HDI.[13]

Arguably, this new pattern can be explained by a cumulative effect, by which increased economic activity has generated more evenly distributed economic outcomes, which may have stimulated growth further. The democratic process (especially social-democratic governments) has played a crucial role in this 'break with history'. A simple inspection of the behavior of aggregate variables suggests the importance of public action in the recent 'redistributive growth', which has been accompanied by a substantial rise in the tax effort (from 17.8% of GDP in 1990 to 28% in 2008) and public social expenditure (PSE; from 9.8% to 16.2%). We have found almost perfect negative correlations between the PSE and the Gini, the PSE and poverty indexes, and the tax effort and the Gini for 2000-2008. Regression analysis for 17 countries with available comparable data (Cornia, 2010) shows that the most important factors in the recent decline in inequality have been educational expansion, social policies such as

[9] See Kerstenetzky 2009.

[10] After growing only 0.3% in 1990 and 0.6% in 1995, GDP grew 3.9% in 2000, 4.9% in 2005 and 4.3% in 2008. (World Bank, 2010).

[11] The Gini index has declined 1.1 points on average (12 countries). Uruguay, Costa Rica, Nicaragua and Honduras are exceptions. See López-Calva & Lustig (2010).

[12] Cornia (2010).

[13] The correlation coefficients between the Gini index and the per capita GDP were -0.78 in 2000, -0.84 in 2005, and –0.72 in 2008. For the same years, the correlations between the Gini and the HDI were -0.57, -0.55 and -0.66.

social security and cash transfers to the poor, labor market policies, and macro policies, especially the exchange rate regime.[14] The GDP growth rate in itself has had a mild negative impact on the Gini index, the impact being higher in countries governed by left-of-center coalitions.[15] A fine-grained analysis for four countries (the three biggest economies: Argentina, Mexico and Brazil, plus Peru) has also found the shrinking wage gap and the social policies as the major factors in the recent inequality decline (López-Calva & Lustig, 2010).

In short, following the restoration of democracy and the upturn in the global economy, redistribution of social and economic entitlements and micro and macro policies seem to be the critical background factors in the recent advances in the region. In what follows, we focus on the Brazilian experience, as it shows promise in terms of sustainable delivering equitable and efficient results, to see more closely the interaction of these factors and to shed light on some of the (still huge) challenges ahead.

Starting in 2004, under the left-of-center government of Luiz Ignácio Lula da Silva,[16] Brazil has simultaneously experienced high levels of growth[17] and decreasing rates of poverty, inequality, unemployment and labor market informality. As the case for other countries in the region, to a certain extent this can be said to have resulted from a combination of favorable economic circumstances and democratization, which has helped to spread the benefits more evenly. But there are peculiar traits to this recent growth in the country that suggest a closer connection between economic and social factors, mediated by 'left-leaning' policy decisions, which may be pointing to a new 'social developmental' experiment.[18] We highlight labor market policies, which have introduced yearly real increases in the minimum wage, introduced some tax simplification, strengthened monitoring of employment situations, and tied credit from official banks to labor formalization; social policies, among them the expansion of non-contributory social security and cash transfers to the poor; and participatory public policies. The interaction of these policies has resulted in a sustained upsurge in the

[14] Competitive (or controlled) exchange rate has been relevant to reduce inequality in most countries in the region, the exceptions being Brazil and Venezuela which have adopted fluctuating exchange rates. Cf. Cornia 2010.

[15] Cornia 2010.

[16] Lula took office in January 2003.

[17] Over 5% p/y from 2004 to 2008.

[18] See Kerstenetzky 2010.

purchasing power of low-income classes, which has been the major macroeconomic impetus in the recent growth process.[19]

It is easy to understand the impact of these policies, not only in boosting growth rates, but also in reducing inequality. Brazil has taken advantage of the expansion of its internal consumer market with a regulated labor market that has protected the minimum wage and stimulated formal employment,[20] so that the new jobs created in the wave of the increasing aggregate demand have been mainly formal ones. In this regard, it is remarkable that unlike other emerging economies such as India and China, where high growth has been accompanied by increasing inequality and sluggish employment response, Brazil has witnessed relatively high GDP growth rates along with proportional employment growth rates, and more than proportional formal employment growth rates. The policy for yearly real increases in the minimum wage also affects other non-labor incomes, such as pensions and other constitutionally guaranteed social benefits, since the 1988 Constitution established the minimum wage as the floor for all social benefits. Thus, the minimum wage has become a crucial social index for leveling household income distribution. Participation has also been important as a political mechanism in the conception and implementation of decentralized public policies, as designed in the 1988 Constitution, but also as a mechanism of regular consultation of the executive levels with civil society, more effective in some cases (for example, the criterion for adjustment of the minimum wage above inflation was discussed and proposed by one such participatory forum, the National Council on the Minimum Wage) than in others (for example, macroeconomic policies, which are insulated from participatory mechanisms).

Proactive social policies and guarantees of social rights have been achieved, on the 'demand' side by democratization and the drafting of the 1988 Constitution, which itself resulted from massive involvement of civil society organizations; and on the 'supply' side by the ensuing expansion of social expenditures and tax effort, which jumped from 17% of the GDP in 1990 to 26% in 2008, and from 26% to 35% of GDP, respectively, both rates well above the regional averages. To be sure, during the 1990s through to the beginning of the 2000s, the successive administrations introduced market–oriented reforms, tight monetary policies, and strong fiscal adjustments to reduce the public

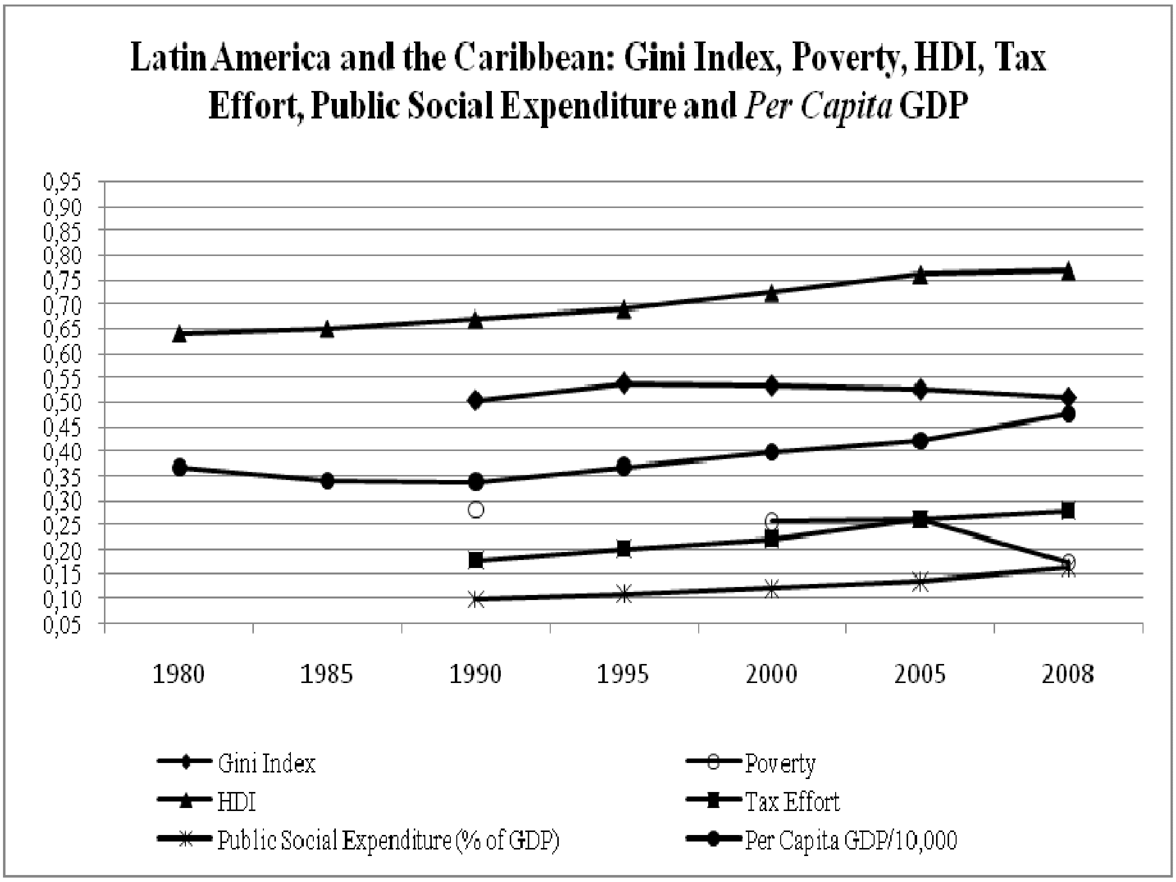
[19] Investment rates have recently responded positively so that inflation pressures are at bay, by the moment.

[20] Regulated jobs that pay at least the statutory minimum wage.

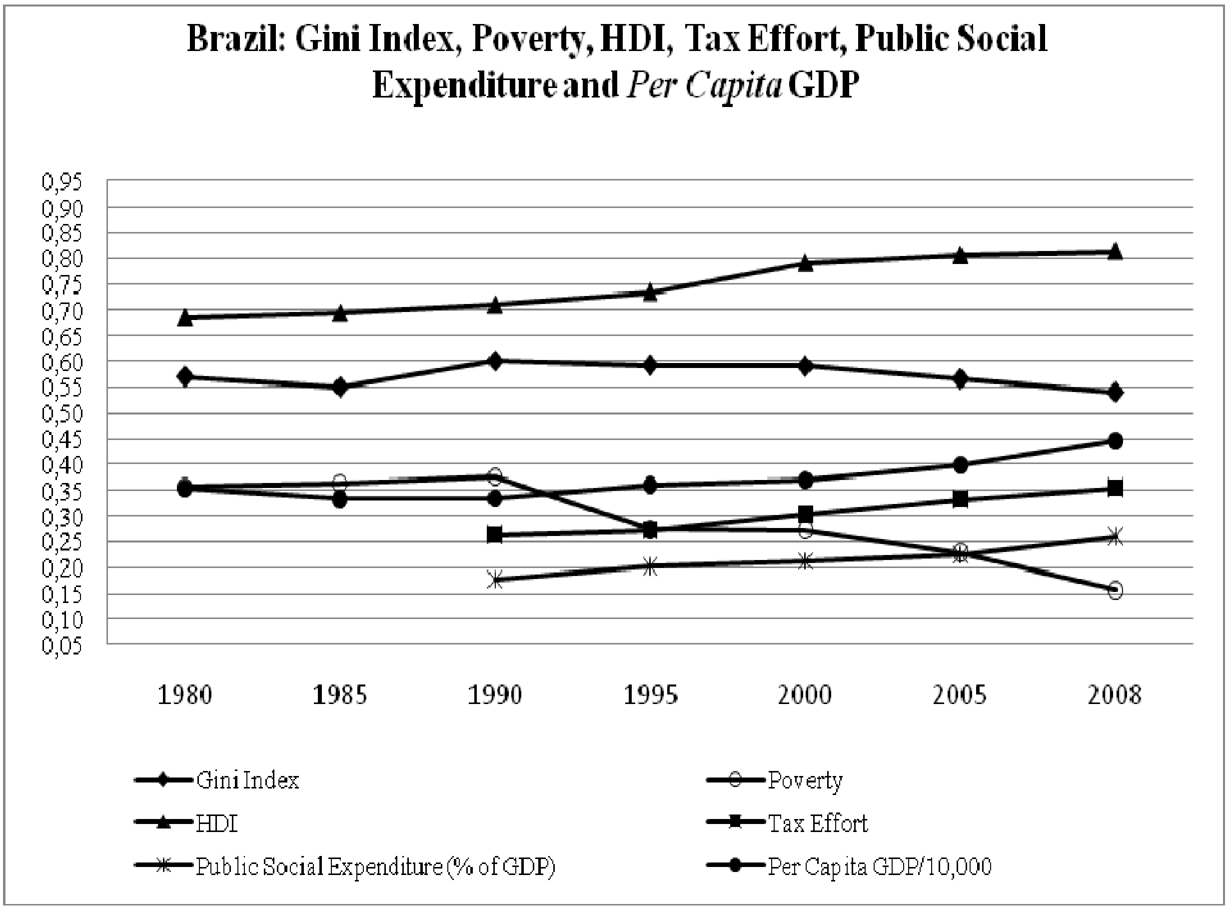
deficit, among which the implementation of fiscal discipline to generate fiscal surpluses to reduce the debt/GDP ratio. But public expenditures have mostly not diminished. Non-financial expenditures have actually increased, especially in the 2000s -- and the public deficit has decreased -- on account of the higher tax effort. Starting in 2007, the Lula administration has incrementally tried to gain fiscal leeway. Without losing sight of fiscal prudence, the government has introduced more flexible fiscal surplus targets. This has been done more recently by adjusting the targets as anti-cyclic policy tools, a measure that proved successful to weather the effects of the 2008 global crisis; and previously, by reclassifying certain social expenditures as "investments" and thus not counted in fiscal surplus estimations. This has made room for an important public project, the Growth Acceleration Program (PAC), which includes investments in urban and social infrastructure, some with a participatory component, such as housing and slum urbanization.

As in most countries in the region, some major concerns are the still limited redistributive reach of social expenditures, of both transfers and social services; the notoriously regressive tax system, strongly based on indirect taxes and social contributions; and the severe concentration of wealth and social entitlements in general. In comparison to developed countries, social services, the major equalizing force in contemporary welfare states (Esping-Andersen & Myles, 2009), are substandard. The potential of the public provision of these services to generate formal employment, and thus to improve the notoriously defective labor market dynamics, has thus been underexplored. The social transfers, though mostly effective, are timid (1% of GDP), lacking integration and even legal security (the *Bolsa Familia* program is not a constitutionally guaranteed right).

Undertaking the necessary changes will crucially be decided in the complex and in many respects still old-style political arena, but the good news is that the new democratic practices, in interaction with the normative horizon set by the 1988 Constitution, have institutionalized an enlargement of political participation, thus giving voice to traditionally unheard actors.



Source: Own elaboration on data from SEDLAC, PNUD, CEPAL and The World Bank Group. Sources: Gini Index – SEDLAC; HDI – PNUD; Public Social Expenditure – CEPAL; Poverty – SEDLAC; Tax Effort – CEPAL; *Per capita* GDP - The World Bank Group. HDI data for 2008 refer to 2007; Poverty includes percentage of population living with less than US$ 2.5 per day; Poverty data for 1990 refer to 1992; Poverty data for 2000 refer to 1998; Poverty data for 2005 refer to 2003; *Per capita* GDP in constant US$ 2000.



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