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Protection Systems in Latin America: Toward Universalism and Redistribution

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Chapter 10:
Social Protection Systems in Latin America: Toward Universalism and Redistribution*

By José Antonio Ocampo and Natalie Gómez-Arteaga

Latin America saw significant improvements in its social indicators over the 2003-13 decade, including reductions in income inequality in most countries in the region–in sharp contrast to a global trend toward rising inequality both in developed and developing countries. These improvements were matched by a fair economic performance, particularly in 2003-08, though with a slowdown in 2008-13. Improvements in income distribution combined with a fair economic growth resulted in a massive reduction of poverty, the fastest since the 1970s. Aside from favorable external conditions (high commodity prices and ample access to external financing), improvements during this "golden social decade" can be attributed to the construction of stronger and innovative welfare states. New forms of social protection have been emerging in the region, including the universal basic pensions of Bolivia, Brazil, and Chile, the universal health system of Colombia, the growing attraction of the cash transfer programs, as well as universal transfers like child benefits in Argentina. The region has also experienced the expansion of contributory social security, in Ecuador and Uruguay, among others, and reversals of pension privatizations in Argentina and Bolivia. These advances have also been matched by progress in other dimensions, such as the significant increases of wages and the rapid increase in access to education, despite remaining quality gaps.

With the recent improvements and innovations on Social Protection Systems (SPS), the region is going back to the roots of the conceptions on which the welfare state was built in industrial countries, which underscores the universalism and solidarity of a social policy based on the principle of social citizenship. After an important debate and policies that emphasized targeting of state subsidies for the poor and the design of competitive schemes for social service provision with participation of both public and private agents, Latin American countries are moving back toward more universal and comprehensive SPS.

This paper reviews the targeting vs. universalisms debate and assesses recent improvements of 18 Latin American countries in three dimensions of social protection aimed at measuring universality, solidarity and public spending. Between 2002 and 2012, 17 out of the 18 Latin American countries improved their score in their social protection index, meaning they increased coverage of both health and pensions, reduced coverage gaps between wage and non-wage earners, increased social spending and/or had higher efficiency of social assistance. However, important inequalities remain, both by type of employment and income. Non-salaried workers are always less likely to be affiliated to health and pensions, and pension coverage is still highly deficient, both in terms of low affiliation among the working population and low coverage of pensions during old-age.

The incidence of social spending on poverty and inequality has been significant, especially that of the more universal benefits. The redistributive effect is higher for indirect transfers than for direct transfers, which shows that Latin American universal direct transfers are still limited while targeted transfers, although highly progressive, have low benefits and coverage. In any case, Latin America achieves lower fiscal redistribution than developed countries due to a less progressive mix of taxes and transfers and limited benefits.

At a time where economic growth has already slowed down and is expected to remain weak in the immediate future, particularly in South America, continuing with the expansion of a

* This chapter borrows from a longer paper prepared by the authors for the International Labor Organization (Ocampo and Gómez-Arteaga 2016).

stronger welfare state with universal benefits would be an essential strategy. This is supported by the evidence that there is no trade-off between redistribution and growth. In fact, Latin American countries with a higher score on the social protection index, or even higher social spending, have had higher growth rates. This implies, however, that higher and more progressive taxes are needed.

This paper is divided into six sections, aside from this introduction. The first one reviews the debate between universalism and targeting of social policies in Latin America and the return to the roots that inspired social policy in the past. The second shows the improvements of SPS during the last decade using a multidimensional index to measure their comprehensiveness and universality. The third analyses the present state of SPS and give account of the persistent segmentations in the access to health and pensions. The fourth assess the incidence on poverty and inequality. The fifth shows the inter-linkages between the expansion of social protection and economic development. Finally, the sixth concludes with some general recommendations.

1. Universalism vs. targeting of social policy

The modern conceptions of social policy have their roots in the liberal views on the need to provide basic education and health services as inherent to the progress of modern societies. Since the late nineteenth century, the creation of modern social security systems under the leadership of Bismarck and, particularly, the increasing demands coming from the labor and socialist movements, led to the development of more encompassing views of social policy. The development of the welfare state in the major industrial economies since the 1930s was the results of this process, as well as of the competition with communism in the post-war years. A major corollary of this development was the unprecedented growth in the size of the state.

In Latin America, these views were manifested but its impacts remained more limited. The reforms introduced in the 1910s in Uruguay by President Battle are perhaps the earliest manifestations of this trend. However, the development of most encompassing views of the welfare state remained limited to a few countries: the three Southern Cone countries (Argentina, Chile, and Uruguay) and Costa Rica[1] and, even then, they never paralleled the welfare states of industrial countries, particularly in terms of the development of an encompassing tax and transfer system to reduce income inequality. For most Latin American countries, even the coverage of educational and health policies was low up to the mid-twentieth century and social security came late and very restricted in scope, due to its association with formal employment and its corporatist tones. The result was a segmented and incomplete welfare state which irradiated its benefits to some middle sectors of society and but tended to marginalize the poor, particularly in rural areas.

The market reforms of the 1980s and 1990s placed social policy in a subordinate status.[2] The new views of social policy that were disseminated throughout Latin America by the World Bank since the 1980s can be best summarized in three instruments for social policy reform: targeting, demand subsidies to facilitate a more competitive system with private sector participation, and decentralization. The first tried to make social policy consistent with limited fiscal resources as it tried at the same time to benefit the poor. The other two instruments focused on the need to rationalize the state apparatus. To these we must add the multiplication of specific projects aimed at managing the social costs of structural reforms, the most important of which were perhaps the social emergency funds.

[1] We should add to this list Cuba after its 1958 revolution, but due its entirely different economic, social, and political system, we leave Cuba out of this paper.
[2] This is reflected, for example, in the lack of any special mention of social policy in the ten principles of the "Washington consensus," as summarized by Williamson (1990), except as a priority of public sector spending.

The application of the new principles was uneven throughout the region. Specifically, targeting had its best manifestation in the development of conditional transfer programs, which were developed first as an emergency mechanism ("Progresa" in Mexico) or as an instrument to guarantee broader coverage of basic educational services ("Bolsa Escola" in Brazil) but evolved through time into systems with broader coverage, which eventually aimed at the full coverage of the targeted population, and were renamed as "Oportunidades" and "Bolsa Familia" and copied by other countries. The spread of this transfer is the spearhead of what Ferreira and Robalino (2011) have called the "Social Assistance Revolution."

The result of reforms is that the current systems of social policy combine three different models, sometimes in the same country. The first is the strict universal system with public sector organization and different degrees of decentralization that continues to characterize the educational systems; this also includes variable levels of private provision, particularly in the university system. The second is the segmented and corporatist system inherited from the past that continues to prevail in several countries in social security in its broader sense (health, pensions, and professional risks). The third is the strict targeting schemes, the best developments of which are the conditional transfer programs. Filgueira et al. (2006, 37) have characterized the resulting systems of social policies as "persistent corporativism mixed with liberal reforms." These systems lack a pillar of clearly designed entitlements and perhaps, and most importantly, they lack the coherence and appeal of the old conceptions of the welfare state and thus the capacity to serve as central instruments of social cohesion.

The return of universalism as a paradigm in social policy is closely tied to the concepts of social rights and social citizenship. Internationally, this vision was reflected in the rise of the welfare state and the development of the economic, social, and cultural rights summarized in the Articles 22 to 27 of the Universal Declaration of Human Rights and later in the United Nations Covenant on Economic, Social and Cultural Rights. This new set of rights expresses the modern notions of equality, solidarity, and non-discrimination, which goes back to T. H. Marshall's concept of social citizenship (see Marshall 1992, which reproduces his original 1950 essay). Furthermore, as stated in the preamble to the in the United Nations Charter, they should be conceived as the manifestation of the determination of UN member states to, "promote social progress and better standards of life in larger freedom"–a concept that, as we know, goes back to Franklin D. Roosevelt's "Freedom from Want" and that has most recently been conveyed by Amartya Sen's "development as freedom" (Sen 1999). In Latin America, this view has also been developed by United Nations Development Program in the concept of democracy as the extension of the three dimensions of citizenship (civil, political, and social) (UNDP 2004; see also Ocampo 2007).

The more precise formulation of this conception for Latin America is the chapter on the principles of social policy formulated by the UN Economic Commission for Latin America and the Caribbean (ECLAC) in its report *Equity, Development and Citizenship* (ECLAC 2000). The four principles are: universalism, solidarity, efficiency, and integrality. The first of them expresses the view that the entitlements associated with social policy are more than services or commodities: they are *rights* and should therefore be guaranteed to all citizens. The second indicates something that is obvious, particularly in highly unequal societies: that the guarantee of access of the poor to those entitlements should be based on the principle of solidarity, which furthermore expresses the basic objective of building more inclusive societies. The third indicates the resources available to society for its social welfare programs should be optimally used, whereas the last expresses the fact the there are many dimensions to poverty and inequality that should be simultaneously tackled.

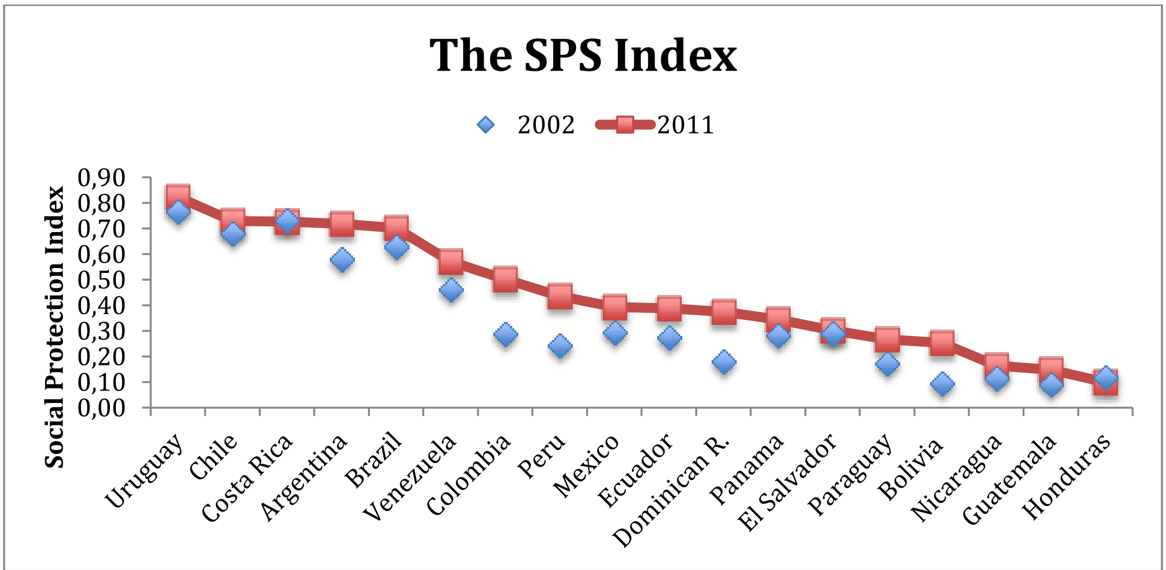
Regarding social protection, in 2008 the International Labor Conference (ILC) adopted the landmark "ILO Declaration on Social Justice for a Fair Globalization." The Declaration institutionalized the concept of "decent work," which has been developed by the International Labor Organization (ILO) since 1999 to promote a fair globalization. This concept puts forward an integrated approach that recognizes employment, social dialogue, rights at work and social protection as strategic objectives, with the latter including "the extension of social security to all" (ILO 2008, 9–10), As a follow-up to this declaration, at the 101st ILC in 2012, 184 members unanimously adopted Recommendation No. 202, which provides guidance to members for establishing and maintaining Social Protection Floors as a core element of their national social security systems, guaranteeing universal access to essential health care and a basic income over the life cycle for all (ILO 2012).

As it will be seen in the next section, Latin American countries have made significant progress in moving toward more universal and comprehensive social protection systems during the last decade, based on the concepts of social citizenship and decent work.

2. A multidimensional index to measure Social Protection Systems in Latin America

The Social Protection Index (SPI) designed for this study[3] measures the achievement of 18 Latin American countries in three dimensions of SPS: universality, solidarity and social Spending (see figure 10.1). [4] This index allows us to differentiate three groups of countries in terms of comprehensiveness and universality of their SPS: (i) Uruguay, Chile, Costa Rica, Argentina, and Brazil, with the highest scores, can be identified as having comprehensive systems; (ii) Venezuela, Colombia, Peru, Mexico, Ecuador, the Dominican Republic and Panama have intermediate systems; and finally (iii) El Salvador, Paraguay, Bolivia, Nicaragua, Guatemala and Honduras have relatively limited SPS (see figure 10.2).[5]

FIGURE 10.1

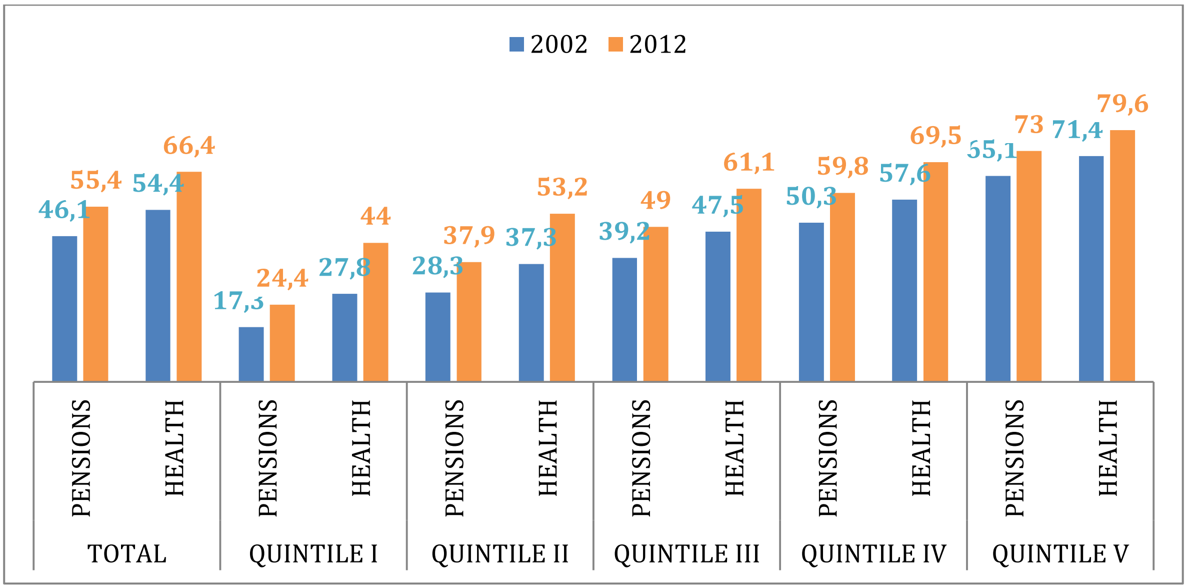


[3] The index goes from 0 to 1, where 1 represents the most comprehensive system with relatively higher universal coverage, less inequality in affiliation to health and pensions for different types of employment, high social inclusion, well targeted social assistance and high social spending.

[4] The dimensions in the index try to reflect the principles of a robust welfare state. Although efficiency and integrality could not be approximated, public spending on SPS is used as a proxy. Cross-country evidence suggests that the higher the budget of social spending, the higher the benefits incidence on poverty and inequality reduction. Furthermore, the size of the budget also reflects the social contract and type of institutions in a given country and the universality of the system. "The hypothesis here is that the size of the budget available for redistribution is not fixed and that the institutional structures of welfare states are likely to affect the definitions of identity and interest among citizens. Thus, an institutional welfare state model based on a universalistic strategy with higher budget intended to maintain normal or accustomed standards of living is likely to result in greater redistribution than a marginal one based on targeting" (Korpi and Palme 1998, 663).

[5] This classification goes in line with different rankings on the topic, all concluding that countries in the Southern Cone have built up more comprehensive welfare states. Costa Rica in itself has always excelled as having a fairly universal welfare state despite its much lower GDP per capita (Cecchini and Martinez 2012)

FIGURE 10.2



Between 2002 and 2012, 15 out of the 18 countries with available data, improved their score in the SPI, meaning they had significant improvements in at least one of the dimensions of SP, moving toward a more universal and comprehensive system. In contrast, three did not experience any change in the indicator. Countries with intermediate SPS improved the most. Colombia experienced the strongest improvement in the SPI score, followed by Peru, the Dominican Republic, and (a country with a limited SPS) Bolivia. In the case of Colombia, the improvement followed the efforts to achieve universal health coverage using a subsidized insurance scheme to reach the poor and independent workers.[6] Colombia significantly increased health coverage for both salaried and non-salaried workers, reducing the affiliation gap between both types of workers. While 53% of salaried workers had access to health in 2002, by 2012 coverage was 91%. The coverage also increased among non-salaried workers, reducing the coverage gap between the two types of employment from 75 percentage points in 2002 to 5 in 2012. Peru, the country with the second biggest improvement in the index, had also significant improvements in the access to health and pensions. Both indicators almost doubled between 2002 and 2012. Also, the coverage of the poorest quintile in social assistance increased from less than 10% to 70%. In turn, Bolivia significantly improved access to pensions among old-age population, passing from coverage of 13% to 21%. Although this coverage is still low compared to other countries, Bolivia achieves almost universal coverage among the elderly (65 and older) with its non-contributory pensions (see section 3 below). Of the countries with comprehensive systems, Argentina is the one that improved the most. This was mainly driven by the expansion of pensions, establishing a mandatory minimum basic pension for all, independently of whether the beneficiary had reached the minimum contribution.[7]

The recent improvements in the SPI responded to efforts toward more universal SPS, with specific policies to include the poor and informal population who have been traditionally excluded. However, as we will see, there is still high segmentation in the access and benefits of SPS by type of employment and income level.

[6] See the case study on universal health coverage in Colombia for the World Bank (Montenegro and Acevedo 2013).

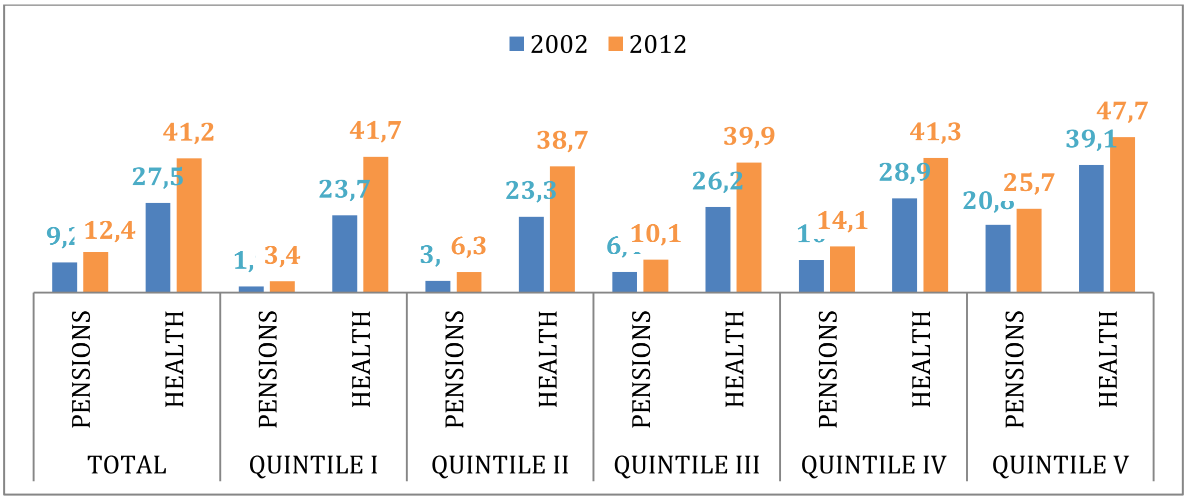
[7] See Lustig and Pessino (2013). Moratoria Previsional (the pension moratorium), introduced in 2004-05, allowed workers of retirement age to receive a pension regardless of whether they had completed the full 30 years of required social security contributions through formal employment.

3. A lower but persistent segmentation of SPS in the region

There have been significant improvements in the access to health and pensions[8] across the region, with recent innovations in flexible contributory mechanisms, basic pensions like Argentina, non-contributory pensions like in Bolivia and Chile, and universal health coverage with important solidarity mechanism as in Colombia, among others.

Between 2002 and 2012, access to pensions and health increased throughout the region, for both salaried and non-salaried workers and all income levels. Due to efforts to achieve universal health care and to solve the problem of limited coverage linked to formal employment, improvements have been higher on health coverage among non-wage earners and for the lower quintiles of income distribution (see figure 10.3).

FIGURE 10.3



The percentage of non-salaried workers that had access to health almost doubled during the past decade, while pensions increased by only 3 percentage points. Interestingly, independently of the type of employment or income quintile, it is always more likely to have access to a health insurance than to be affiliated to a pension scheme, which reflect the higher redistributive impact of health than transfers as will be shown in section 4.

The recent innovations introduced to eliminate the segmentation or “truncation” in the access to protection by type of employment, are a clear sign of the change in paradigm that overtook the region in recent years toward universalism. By the end of the twentieth century, when it became clear that the problem of limited coverage (only covering formal employment through contributory schemes) was not going to resolve itself as countries developed,[9] a wave of innovative mechanisms to provide some form of basic protection for all, especially for self-employed workers, spread throughout the region. Besides the example of a subsidized insurance scheme in Colombia already mentioned, in 2001 Uruguay implemented a Monotax scheme to improve coverage of self-employed workers by unifying different social security contributions and taxes into a single payment through a simplified process, allowing people covered by the Monotax to have the same social security benefits that salaries workers, based on a solidarity principle (ILO 2014b). Argentina had a similar experience with subsidization of social security contributions for self-employed workers and micro-enterprises and, in Brazil, SIMPLES (a simplified taxation scheme designed for micro and small business) has significantly contributed to reducing the social security labor costs of micro-enterprises.

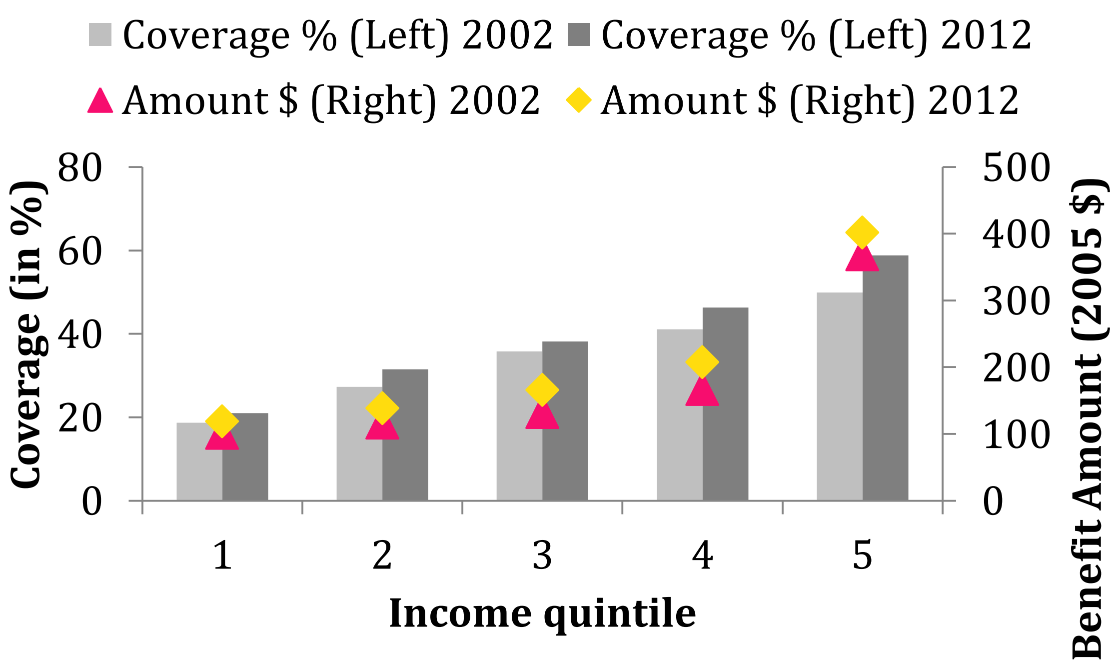
[8] Access to health and pension is a measure of the working age population (15 years and older) that is affiliated to some kind of health insurance (regardless of type of financing schemes) and affiliated to a pension scheme (public or private). Pension is also measured by the percentage of elderly receiving this benefit.
[9] As a consequence of economic growth, it was expected that the informal sector would gradually disappear as workers shifted from more traditional (mainly informal) to more modern (formal) sectors. See Kaplan and Levy (2014).

However, as can also be seen in figure 10.3, despite the improvements since 2002, there are still important segmentations in the access to social protection by type of employment and by income, especially for pensions. While 55% and 66% of salaried workers are affiliated to health services and a pension fund, respectively, only 12% and 41% of non-salaried workers are. In 2012, access to pensions of non-salaried workers in the lower quintile was less than 5%, compared to 24% of salaried workers in the same quintile. Even in the highest quintiles, non-salaried workers have lower access to both pensions and health.

Poor households are also less likely to be covered by both types of protection. This is true in all countries, even in countries with comprehensive systems, although the coverage gaps here are less marked. Interestingly, the coverage gap by type of employment in health is higher among the second poorest 20% compared to the poorest 20%. This reflects the success of conditioning the CCT programs that were targeted to the poorest population on the access to basic services. Thus, the coverage gap on the middle of the distribution is higher.

Protection for the elderly has also increased during the last years. However, according to data available on household surveys, the increases have been higher among the wealthier population. While 59% of the elderly on the top income quintile had access to a pension in 2012, only 21% of the elderly on the bottom 20% had. Inequality in the access to pension during old age is not only associated with coverage by also with amount of benefits. As seen in the figure 10.4, benefits are significantly higher for the top 20% of the population–even in relation to the second quintile.

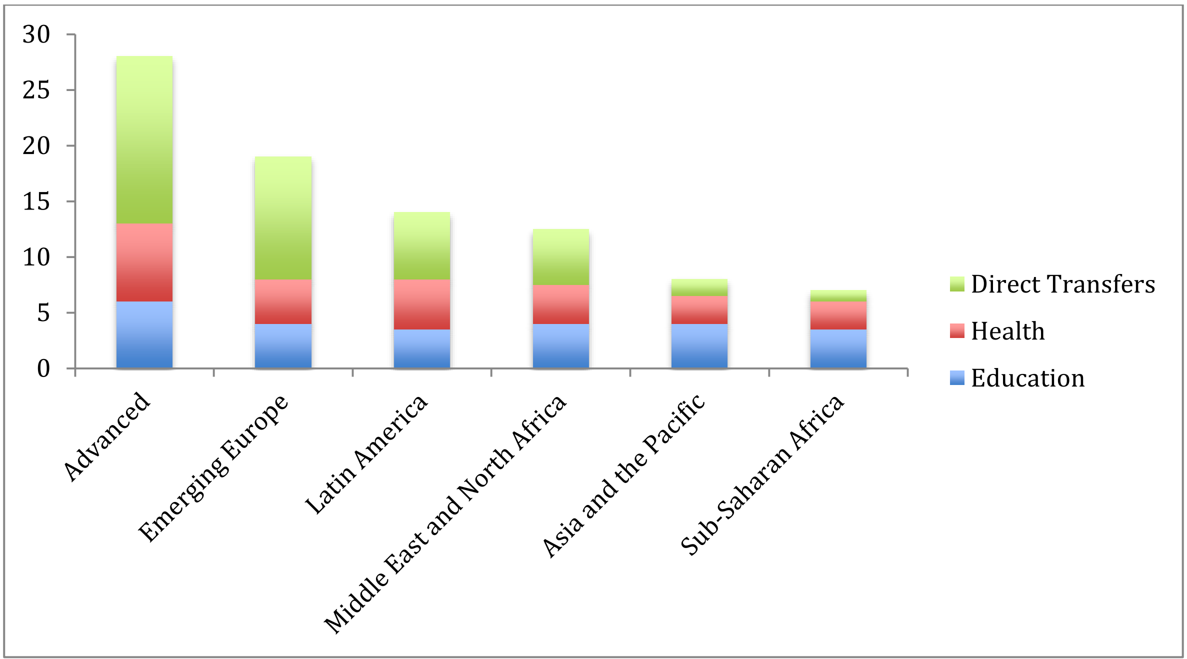
FIGURE 10.4



Given the low coverage of contributory pensions among the elderly, new schemes of non-contributory pensions are emerging in the region, under the leadership of Brazil, Chile and Bolivia. Coverage of this type of pension in Bolivia reaches 95%. In other countries, like Mexico and Panama, non-contributory pensions exist, but as targeted subsidies conditioned on poverty status, and they reach less than 30% of the population, a proportion that has nonetheless increased since 2002 (ECLAC 2015)

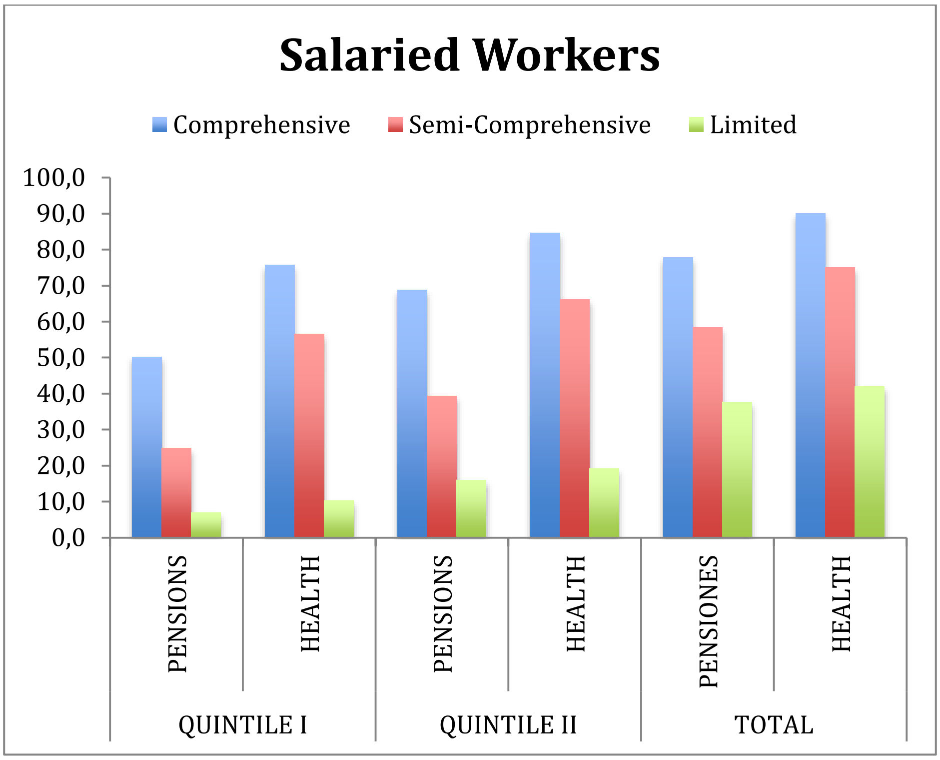
Efforts to expand social protection have come with an increase in social spending. Social spending as a percentage of GDP increased by almost 5 percentage points between 1990 and 2013; 70% of the increase was achieved between 2002 and 2013. The increase was driven mainly by health and social security (insurance and assistance) (ECLAC 2014). However, although Latin America ranks second in the emerging and developing world in terms of social spending as a percentage of GDP, it allocates much less resources relative to developed countries, both for direct transfers (which include social insurance and assistance, non-contributory pensions and other benefits like child benefits) and for health and education (see figure 10.5).

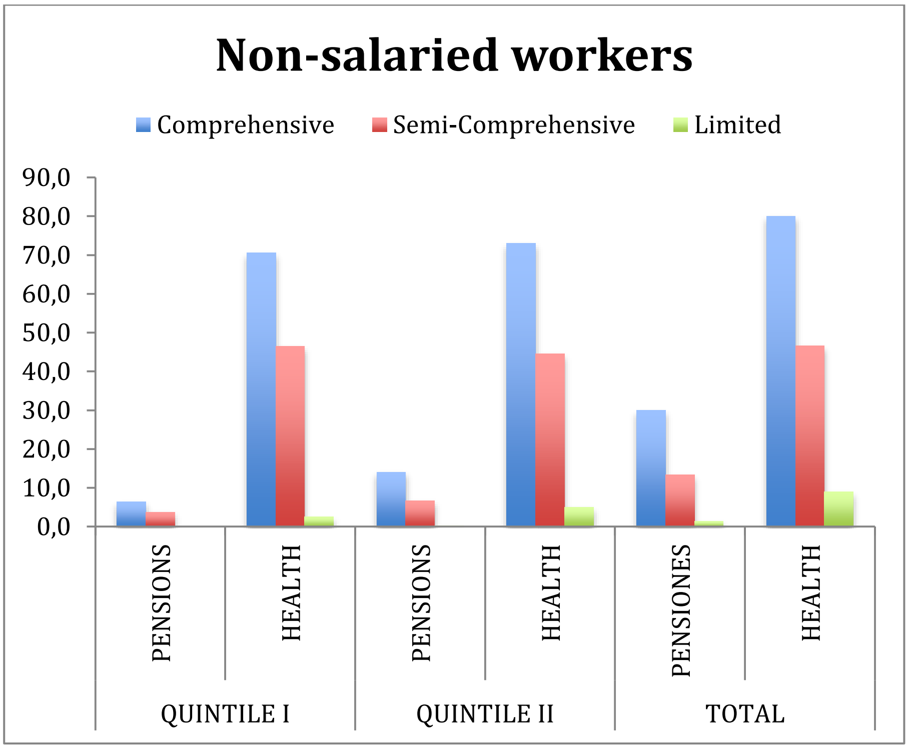
FIGURE 10.5



When looking at the access to health and pensions by the three categories of SPS (see figure 10.6), two conclusions emerge. First, on average, countries with comprehensive systems have higher coverage and do not have important segmentations by income quintile or type of employment in health, although gaps remain in the access to pensions. Second, the differences in coverage between the three categories of SPS are wider when looking at coverage of non-salaried workers. Countries with limited SPS still have the majority of the non-salaried working population excluded from social protection. In these countries, social security is only available for a small proportion of workers with formal employment, in contrast to countries with intermediate and comprehensive systems, which have been advancing in this regard. For example, while 80% and 46% of non-salaried workers in countries with comprehensive and intermediate systems respectively have access to health coverage, only 10% in countries with limited systems do. This gap is much higher than the gap for salaried workers across all types of SPS.

FIGURE 10.06





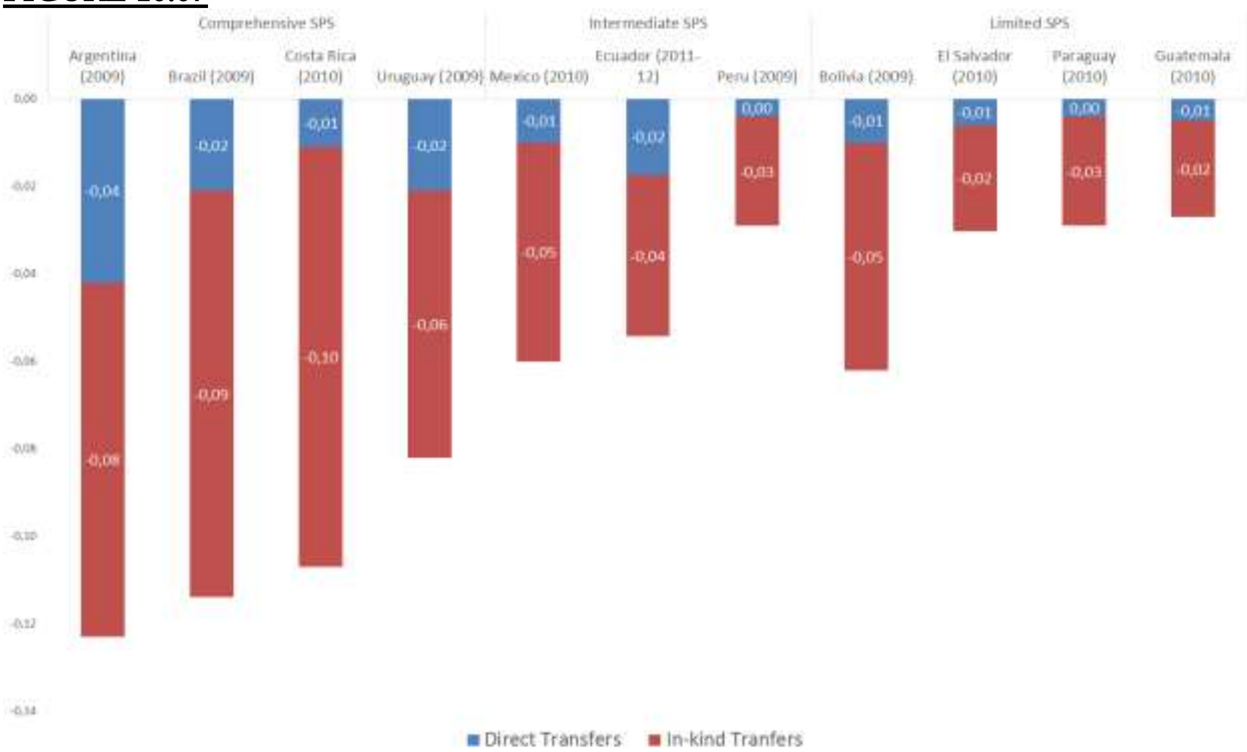
In any case, there is still much to be done. Although targeted programs have been successful in poverty reduction, their effect in reducing income inequality is smaller than universal benefits (see section 4). The next step has to go beyond narrow targeting mechanisms toward more universal SPS, including an expansion of social insurance as countries develop. A universal social protection system that protects people from all types of risks is necessary, not only to continue with massive poverty reduction, but also to increase the resilience of the population above the poverty line, including even the middle class (Ferreira et al. 2013), and construct social citizenship. Without universal protection mechanisms, previous gains could be reversed. This implies, of course, that more resources are needed for social spending.

4. **The redistributive effectiveness of public spending**

The redistributive effect of public spending varies with the characteristics of the Social Protection Systems. Higher social spending, universal coverage, and progressive transfers are associated with a higher redistributive impact.

Using the national studies of the Commitment to Equity Project of Tulane University and the Inter-American Dialogue, [10] it can be estimated that, on average, countries with comprehensive SPS for which information is available reduce inequality by 0.021 points of the Gini coefficient through direct transfers and by 0.085 through in-kind transfers. Intermediate systems do so by 0.01 and by 0.037 points, respectively, while countries with limited systems have almost no incidence on inequality through direct transfers (0.006) and a very small redistributive effect (0.03) through in-kind transfers (see figure 10.7).

FIGURE 10.07

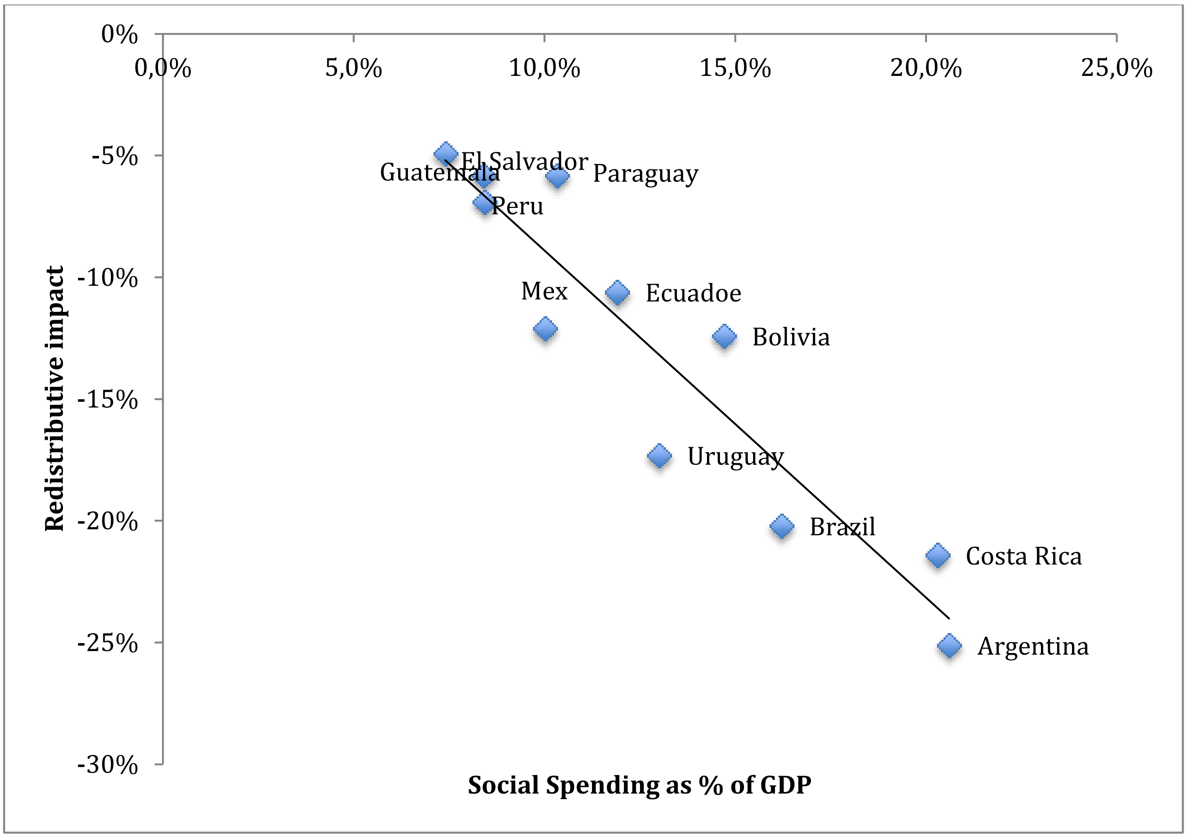


Interestingly, regardless of the type of SPS, the redistributive effect of in-kind transfers is higher than the effect of direct transfers, which reflects the higher budget allocated to this type of transfers and, in most cases, the higher coverage. The budget allocated to health and education as a percentage of GDP is, in all countries, more than twice that allocated to direct transfers, and in several countries, much more. The budget for in-kind transfers varies from almost two times the budget of direct transfers in Paraguay (3.5% vs. 6.7%) to 14 times in Peru (0.4% to 5.9%). Countries with comprehensive SPS tend to have also a higher incidence on poverty reduction through direct transfers. For example, according to CEQ data, direct transfers reduce the head-count ratio by 7.5 percentage points in Argentina, by 3.1 percentage point in Ecuador, and by less than 1 percentage point in Paraguay.

[10] The Commitment to Equity Assessment (CEQ) uses standard incidence analysis to assess the questions of how much redistribution and poverty reduction is being accomplished in each country through social spending, subsidies, and taxes, and how progressive revenue collection and government spending are. The incidence analysis measures the changes in Gini coefficient and poverty indicator between different income concepts (i.e. before taxes and transfers, after direct taxes, and after direct and in-kind transfers). See in the reference section all working papers of the CEQ Project. The data for each country comes from the working paper of each specific country.

Most of the differences in the effectiveness of Social Protection Systems can be explained by differences in the coverage rates, the share of social spending, and the progressivity of transfers. As figure 10.8 shows, there is a clear relation between size of budget for social transfers and their redistributive impact for the countries for which CEQ has published data. The higher the share of resources allocated to social transfers, the higher the incidence on income distribution. In fact, the four countries with a comprehensive SPS have also the highest redistributive impact.[11]

FIGURE 10.08

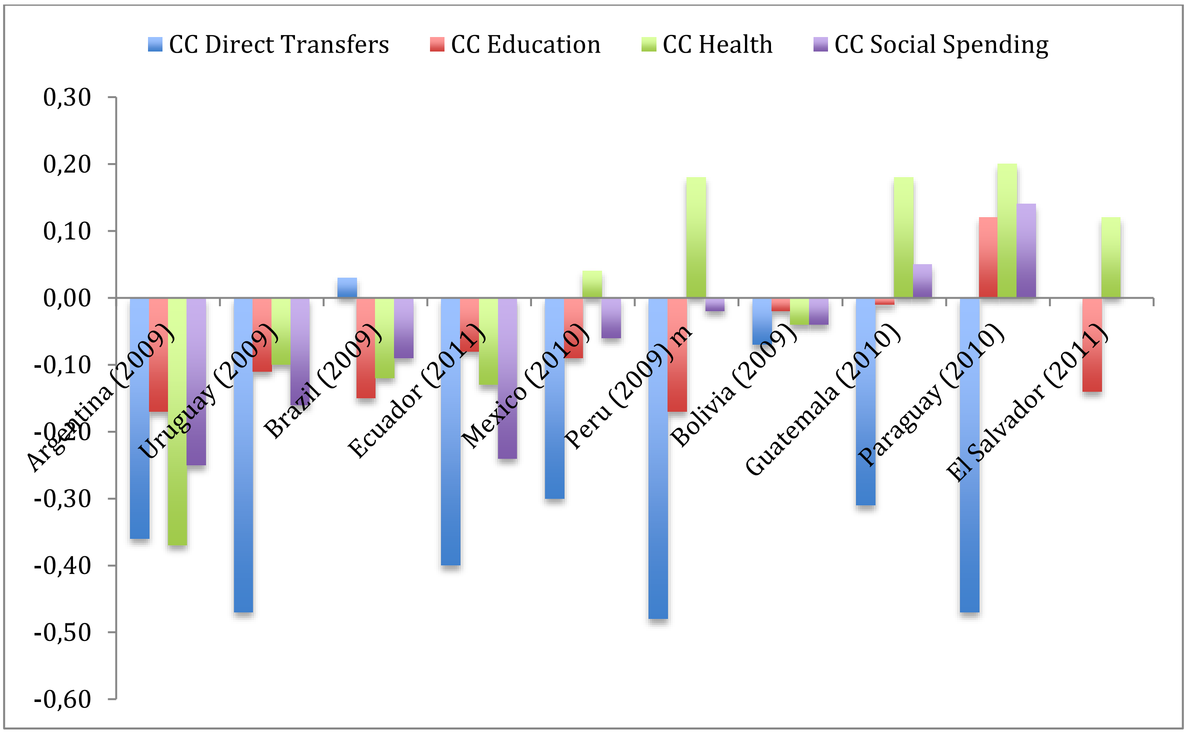


The progressivity of transfers, which measures the percentage of benefits that go to the poorest households, also account for the differences between the redistributive impacts of direct or in-kind transfers. Figure 10.9 shows the concentration (quasi-Gini) coefficients[12] for the different types of social spending. While all direct and in-kind transfers in countries with comprehensive systems are progressive, only direct cash transfers in countries with limited systems are. In countries with limited systems the progressivity of direct transfers is due to the Conditional Cash Transfers (CCT) program, which on average account for more than 70% of direct transfers (Higgings et al. 2013a). In turn, in-kind transfers are regressive in these countries given their lower coverage, as shown for example by the SPI in health.

[11] The relationship applies also to coverage. Ocampo (2008) shows the higher the Human Development Index (excluding per capita income), the higher the redistributive the effect of transfers on income distribution –i.e., the more universal the coverage of SPS, the more redistributive it is.

[12] The quasi-Gini coefficient of social spending fluctuates between -1 (perfect targeting of spending to the poor) and 1, with zero representing a situation in which spending is equally distributed among all social groups.

FIGURE 10.09



In turn, direct transfers are more progressive than in-kind transfers in all countries, except for Brazil. This is highly driven by the CCT program of each country, which is targeted to low-income families as they have a poverty reduction goal, and also by non-contributory pensions in the countries where they exist. However, despite being highly progressive, the overall redistributive impact of direct transfers is lower than the effect of in-kind transfers as was shown in figure 10.9. This is due to the lower spending and coverage of these types of transfers.

In-kind transfers (education and health) achieve the highest redistributive impact when they are universal, like primary education and, in most countries (except mainly countries with limited systems, where it is still linked to formal employment), health care. In all cases, basic education is highly progressive, and is also the most universal in-kind transfer and has a high share of social spending. This combination results in a very high redistributive impact. Health is also highly progressive in countries with comprehensive systems, as it is linked to universal coverage.

The high redistributive impact of social policy in countries with comprehensive system is achieved through a combination of high social spending, universal coverage, and progressive benefits (e.g., Argentina). On the contrary, countries with limited systems spend a lower budget in both direct and in-kind transfers, and although direct transfers are highly progressive, as they target the poorest household, in-kind transfers are regressive (especially health, as they have limited coverage and thus the total effect is a low redistributive impact. In any case, the redistributive effect of fiscal policy in Latin American countries is much smaller than in OECD countries (OECD 2011).

5. The myths regarding the links between economic growth and redistribution

Although national SPS around the world have achieved important reductions in poverty and inequality (ILO 2014a), there are still some myths regarding the relationship between social protection and economic performance.[13] These are:

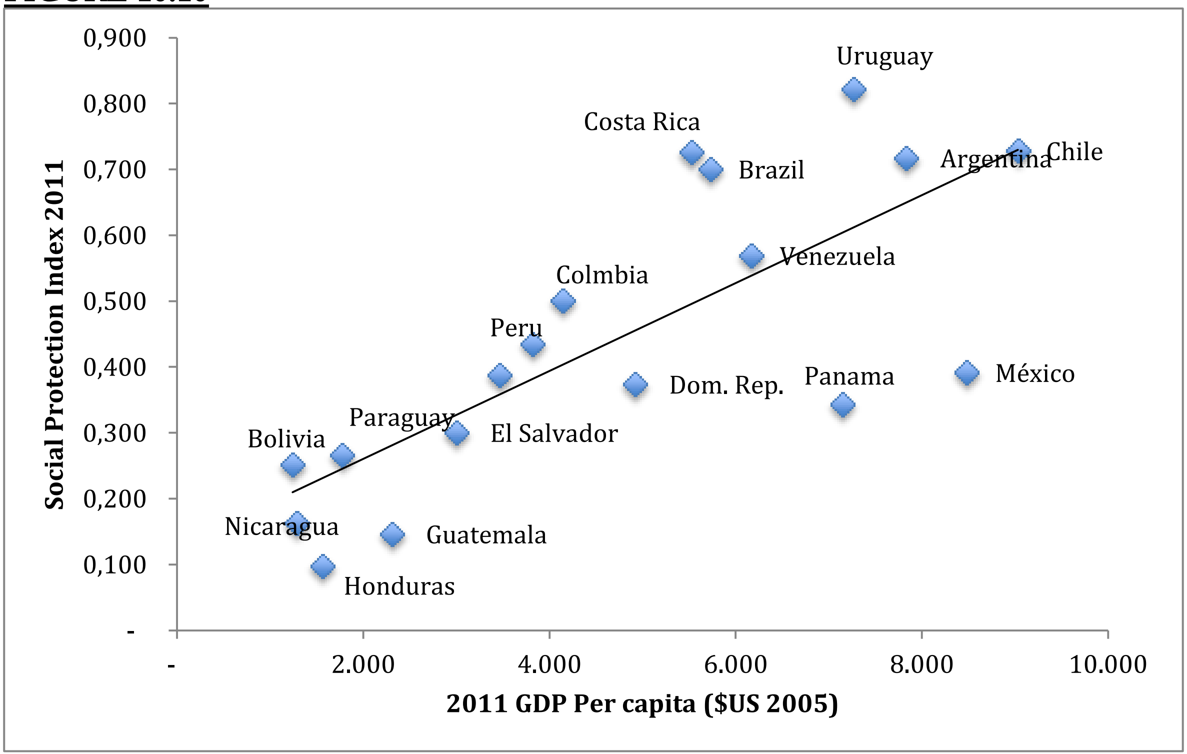
[13] See (Cichon and Scholz 2009) for a revision of these myths in OECD countries

i. At each stage of development, societies can only afford a certain level of social expenditure (the affordability myth).
ii. There is a trade-off between social expenditure (redistribution) and economic growth (Okun's famous trade-off –which, as we will show, is also a myth).
iii. Economic growth will automatically reduce poverty (trickle-down myth).

Based on the recent experience of Latin America, it is possible to refute these myths. First, there is high heterogeneity in the SPS in the region even when per capita GDP differences are taken into account. Second, there is no clear evidence that countries that expanded their SPS grew less. And third, there is stronger correlation between the improvements in the SPI and poverty reduction than between growth and poverty reduction.

Although there is a positive association between higher GDP per capita and a higher Social Protection Index (SPI) score,[14] there is high variation in the SPI by level of GDP per capita (see figure 10.10). The best comparisons are Costa Rica vs. Panama, and Uruguay vs. Mexico. Costa Rica, with a little more than the region's average GDP per capita, has the second highest SPI score. Since 1941, Costa Rica has promoted universal health coverage both of health and pensions as mandatory pillars of the welfare state. With lower GDP per capita, Costa Rica has always excelled at social inclusion indicators. On the other hand, Panama has a higher GDP per capita but has a relatively low social spending and ranks low in the SPI. The same is true when we compare Uruguay and Mexico. Mexico, despite having the second highest GDP per capita in the region, has an intermediate SPS, even more limited that many countries with lower GDP per capita.

FIGURE 10.10



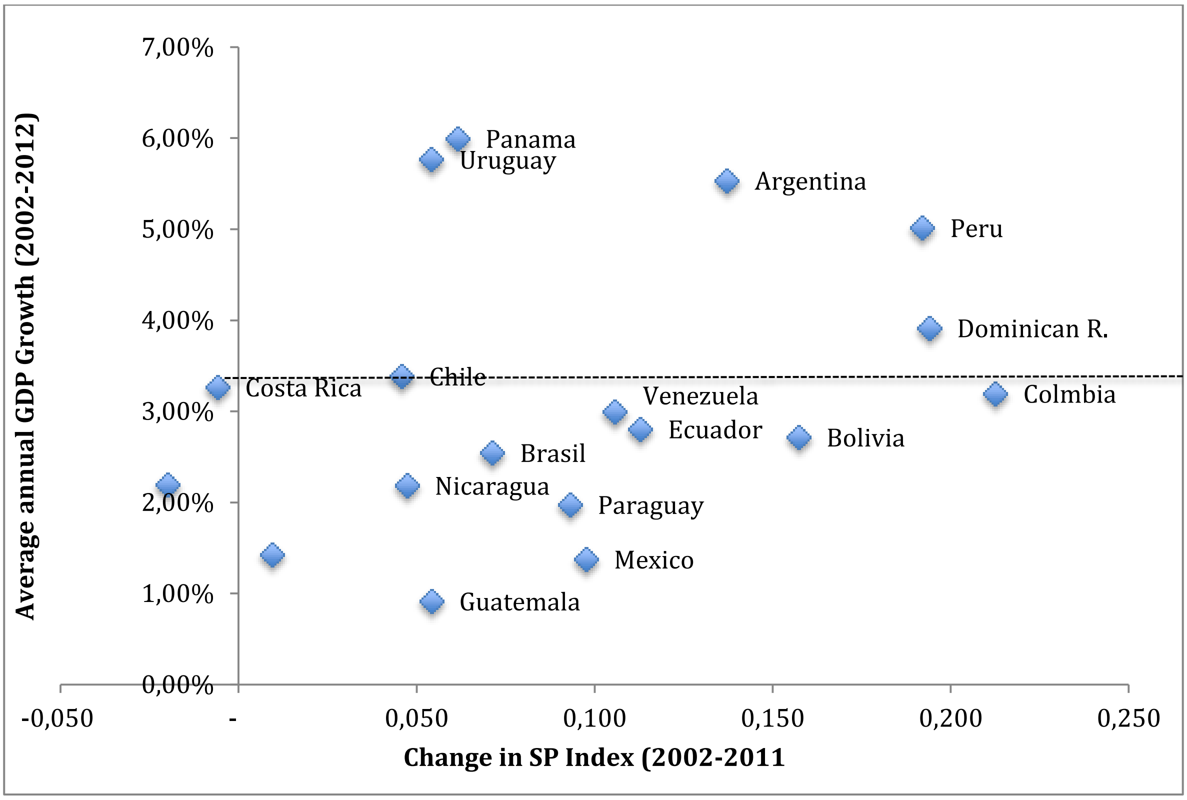
Thus, it is not true that, at each level of GDP, countries can only afford to spend a certain amount in social protection. In fact, given the time it takes to build well-functioning social protection, waiting for the introduction of comprehensive Social Protection Systems until high levels of GDP have been achieved is not an efficient option (Cichon and Scholz 2009)

In turn, figure 10.11 shows the change in the SPI between 2002 and 2012 and the average annual growth rate of GDP per capita. As can be seen, there is no negative association

[14] The same results for myth 1 and 2 hold when looking only at percentage of social spending.

between improvement in SPS and economic growth. Rather, the correlation between these two variables is close to nil (-0.007). And, in fact, the three countries that increased their SP Index the most —Peru, the Dominican Republic, and Colombia—grew at faster rates than the average in Latin America over the period analyzed. There is, therefore, no evidence of a trade-off between expanding SPS and growth.

FIGURE 10.11



This goes in line with recent studies that find no evidence of a trade-off between redistribution and growth (Ostry et al. 2014). This has, of course, major implications for public policy. According to the study: "Redistribution appears generally benign in terms of its impact on growth; only in extreme cases is there some evidence that it may have direct negative effects on growth" (Ostry et al. 2014, 2). This means that the combined direct and indirect effects of redistribution—including the growth effects of the resulting lower inequality—are, on average, pro-growth.

Finally, the last myth argues that economic growth will automatically reduce poverty. Poverty in Latin America decreased significantly during the 2003-13 decade. While in the beginning of the 2000s, 43% of the population in the region lived in poverty, the poverty rate in 2013 was only 28%, according to ECLAC data. The rapid poverty reduction of the region during this decade relied on a combination of both high economic growth and redistribution. Economic growth was significantly pro-poor, in the sense that incomes of the lowest deciles of the distribution grew relatively more than the incomes at the top; also, faster growth translated into higher formal employment. In turn, higher social spending had important redistributive effects, thus reducing poverty and also the inequality among the poor[15] (Lustig et al. 2013).

As can be seen in figure 10.12, both higher social protection index (high social spending) and higher GDP per capita reduce poverty. However, and interestingly, the correlation in Latin America seems to be higher between changes in the SPI and poverty reduction (Figure

[15] See Cecchini (2014) and Fiszbein et al. (2009).

10.12a) than between annual growth rate of GDP per capita and poverty reduction (Figure 10.12b).[16]

FIGURE 10.12a

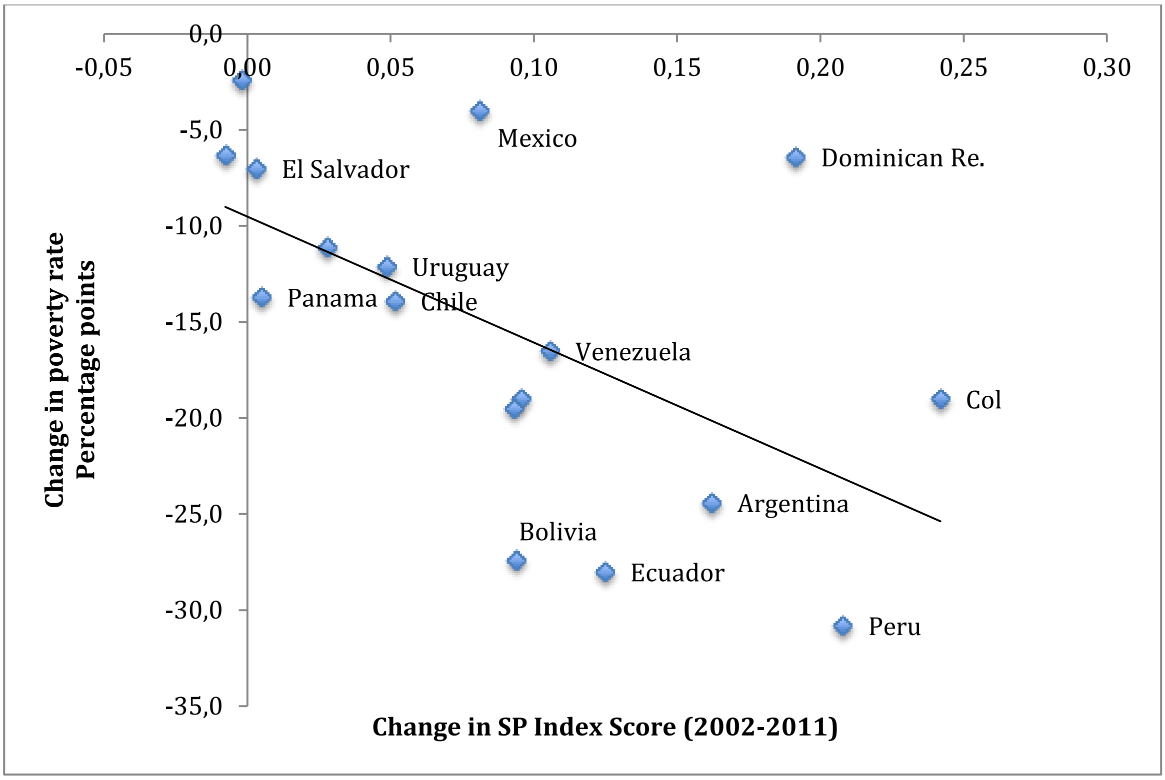
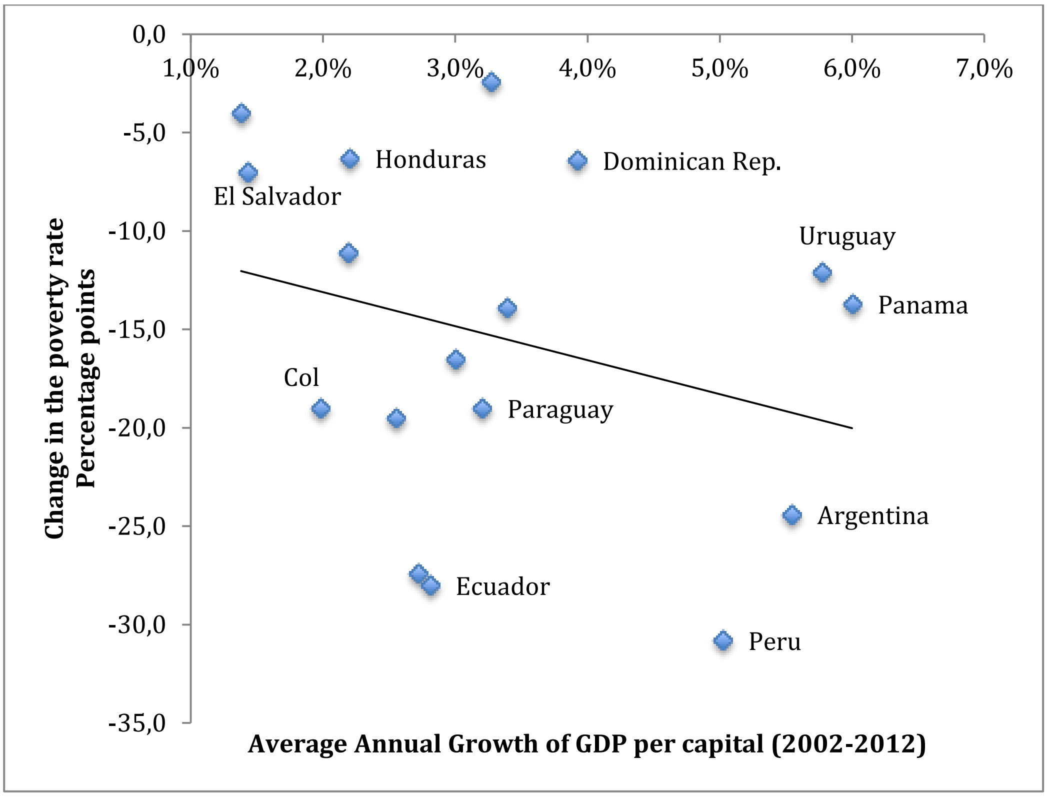


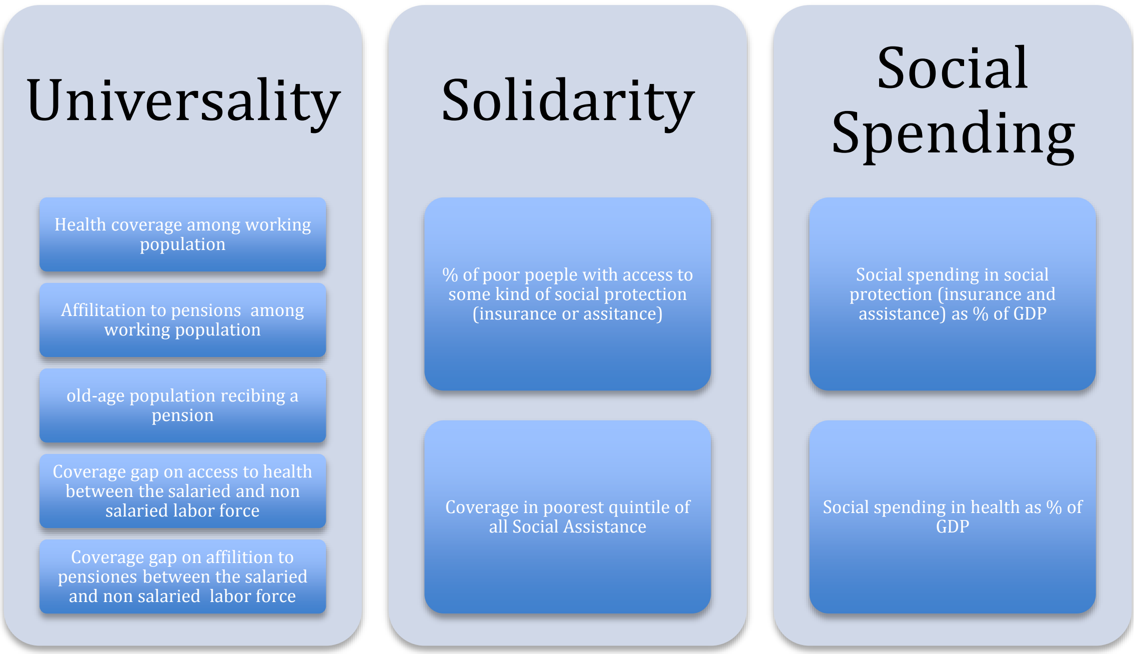
FIGURE 10.12b



[16] Even running some simple regression the R^2 of the SPI is higher and it more significant than the regression with GDP per capita.

This indicates that poverty reduction is more strongly associated with an increase in the SPI, than with GDP growth rates. Based on a regression analysis (see table 10.1), although both economic growth and the social protection index are positively correlated with the poverty level, when looking at the standardized beta coefficient, which represents the change in the poverty rate for every one standard deviation change in the explanatory variable, it can be seen that the effect of one standard deviation change in the SPI is stronger than that for GDP capita on poverty reduction (models 3 and 4). This should not be interpreted as a choice between transfer-based poverty reduction and growth-based poverty reduction, but rather as evidence of their strong complementarities. Without well-designed redistributive mechanisms, such as comprehensive SPS, economic growth may not have important effects on poverty, and these effects may not be automatic.[17]

TABLE 10.1



Given the expected lower economic growth of the region in the next year, continuing with the expansion of SPS and universal coverage may be the best possible strategy for poverty reduction and for continuing the positive social trends of the 2003-13 decade.

6. Conclusions

Given the still high levels of labor market informality in most Latin American countries, as well as low mandatory contributions, low coverage of contributory social protection, and low redistributive impact of fiscal policy, the challenges of social policy in an era of slower economic growth will be large. New solutions with regard to both transfers and taxes are needed. Moving toward universal benefits and an expansion of non-contributory social protection mechanisms are needed, in parallel with labor formalization efforts and flexible mechanisms to increase social insurance contributions and benefits. The rising middle class has come with new demands for social protection and more of the same will not be enough: more resources (increasing contributions but also taxes) and universal coverage (with a mix of contributory and non-contributory schemes) are essential. Social assistance programs with targeted benefits, a large focus of attention in recent decades, are simply not enough.

Universal coverage of social services should thus be the essential objective of social policy and is the best guarantee that the redistributive impact of social spending is progressive.

[17] Cichon and Scholz (2009) arrive to same conclusions on a similar analysis for other countries studied.

Universal benefits will be more effective in reducing income inequality and creating more equal societies. Causality goes both ways in this case: more equal societies demand more universal systems of social policy, but the latter contribute, in turn, to equality. A further advantage of universal social policies is their political appeal, and particularly their appeal to the middle classes, which is, in turn, essential to get the political backing for the public sector resources necessary to make universal policies effective.

The major challenge is, however, on the fiscal regime, and the crucial issue in this regard is the low tax income of Latin America, particularly of personal income taxes, as well as its mix with low transfers, as pointed out extensively by ECLAC, the World Bank, and the IMF (see, for example, IMF 2014 and 2015). In fact, according to a recent study, there is "fiscal impoverishment" in Latin America due to the fact that benefits from transfers can be lower than the incidence of taxes and thus fiscal policy may hurt the poor (Higgins and Lustig 2015). The capacity to raise taxes—and, particularly, the more redistributive taxes—to achieve more universal systems of social spending is thus the domain where the battle of equity should be fought in years to come.

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