

**Working Paper No. 27, 2012**

**The Double Challenge of  
Market and Social Incorporation**  
Progress and Bottlenecks in Latin America

Juliana Martínez Franzoni and  
Diego Sánchez-Ancochea



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Martínez Franzoni, Juliana and Sánchez-Ancochea, Diego 2012: "The Double Challenge of Market and Social Incorporation: Progress and Bottlenecks in Latin America", **desiguALdades.net** Working Paper Series No. 27, Berlin: **desiguALdades.net** Research Network on Interdependent Inequalities in Latin America.

The paper was produced by Juliana Martínez Franzoni and Diego Sánchez-Ancochea during their Fellowship at **desiguALdades.net** in 12/2011.

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# The Double Challenge of Market and Social Incorporation

## Progress and Bottlenecks in Latin America

Juliana Martínez Franzoni and Diego Sánchez-Ancochea<sup>1</sup>

### Abstract

Latin American countries have historically failed to secure market incorporation (e.g. people's participation in the cash nexus, which in turn requires the creation of a sufficient number of formal well-paying jobs) and social incorporation (e.g. decommodification of rights) simultaneously. High structural heterogeneity in production and weak fiscal capacity resulted in dual social systems and extended and informal labor market. Has this changed in recent years? This paper draws on the experience of Bolivia, Brazil, Chile, Peru and Uruguay to answer this question. We distinguish between short term outcomes – which may depend on benign international conditions – and policy changes which are more important for long term success. Our analysis highlights Brazil and Uruguay's unique success overall and also shows that all countries have done better in terms of social than market incorporation. We also discuss some of the challenges to secure further improvements in market and social incorporation in the immediate future, including competition from China and low state capacity.

**Keywords:** economic policy | social policy | social and economic incorporation

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<sup>1</sup> We thank participants in workshops at FLACSO (Quito) and [desiguALdades.net](http://desiguALdades.net) (Berlin) and Barbara Fritz and Rosemary Thorp for comments on previous draft of this working paper. This working paper is part of an on-going collaborative research on the determinants of social policy and its links with economic models.

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## Contents

<b>1.</b>	<b>Introduction</b>	<b>1</b>
<b>2.</b>	<b>Income Distribution and the Double Incorporation in Latin America</b>	<b>4</b>
<b>3.</b>	<b>Latin American Historical Failure to Accomplish Economic and Social Incorporation</b>	<b>8</b>
<b>4.</b>	<b>Progress in Market and Social Incorporation Since 1995</b>	<b>10</b>
	4.1 Market Incorporation	11
	4.2 Social Incorporation	14
<b>5.</b>	<b>How Sustainable Are These Improvements? A Look at Policy Change</b>	<b>16</b>
	5.1 Market Incorporation	17
	5.2 Social Incorporation	23
<b>6.</b>	<b>Conclusions: Summary, Prospects and Challenges</b>	<b>29</b>
<b>7.</b>	<b>Bibliography</b>	<b>32</b>

## 1. Introduction

Latin America's recent improvements in income distribution have surprised some and raised skepticism among many. Latin America's high inequality has many dimensions: the wealthiest ten per cent of the population control a higher percentage of income than anywhere else in the world; social exclusion is high; race and gender discrimination reinforce income inequality and different socioeconomic worlds coexist next to each other without much interaction. Across Latin America, albeit in different degrees, one of the most important, entrenched and challenging dimensions behind inequality has to do with securing good jobs and comprehensive social rights for all. This paper focuses on market and social incorporation as two necessary, yet non-sufficient conditions to diminish inequality. How much progress has the region made and how sustainable are these changes?

Market incorporation refers to people's participation in the cash nexus, which in turn requires the creation of a sufficient number of formal well-paying private and public jobs. Social incorporation refers to people securing their well-being independently of the cash nexus, that is, in a non-commodified or de-commodified fashion (Esping-Andersen 1990). This is important for a number of reasons. First, at any given point most people do not participate directly in the market economy either because they are too young, too old, sick or disabled. Secondly, economic cycles come and go and people need to have safety nets to buffer economic uncertainty. Third, incorporation into the market economy requires the formation of so called "human capital" which most people may not be able to afford privately and/or are not always provided effectively by the market. Last but not least, each country explicitly or implicitly establishes a certain "floor" of social rights, provision of which cannot be left up to market forces. Policy tools to reach de-commodification can be broken down into three types: social insurance (where there is a direct relation between contribution and benefits), social assistance (non-contributory and targeted) and universal (non-contributory and non-targeted). All three may accomplish some level of social incorporation yet only universal policies will incorporate the population at large.

The political and policy challenge of securing either market or social incorporation is a complicated task. Securing both at once is even more complicated. It requires a combination of sustained economic growth, dynamic structural change, expansion of social spending and effective relations between economic and social policies. On the one hand the former must financially sustain the latter; on the other hand, social policies must provide the economy with sound inputs such as human capital (Martínez Franzoni and Sánchez-Ancochea, forthcoming).

Historically, most Latin American countries have failed to reach and sustain a double incorporation. Slow expansion of the manufacturing sector, large differences in productivity and innovation between various economic sectors, low tax bases and exclusionary social policy regimes dominated by social insurance along occupations, have resulted in highly segmented market and social incorporations. Although there are major differences between countries depending on their historical paths and levels of development, overall people with good jobs have also benefited from generous social rights. Inequalities in income but also in levels of uncertainty and exposure to social risks have been unsurprising results.

In the last decade, the regional record has shown significant improvements with the steady growth of formal jobs and the creation of innovative social programs. A significant part of recent achievements, however, may have resulted from externally driven high rates of economic growth that will not last forever. Our goal is to discuss the direction of change and to learn how sustainable changes are. We therefore concentrate on the shifts in policy towards market and social incorporation in recent years with particular attention to policies towards structural change (usually referred to as “industrial policies”) friendly to job creation and to social programs that provide transfers and services to more people.<sup>1</sup> We seek to map two types of changes: short-term outcomes and, more importantly, policy trajectories. Here, however, we do not try to explain the determinants of these changes – something that would require more than one paper and that we have tackled for the specific case of Costa Rica in another publication (Martínez Franzoni and Sánchez-Ancochea 2012).

Since a detailed discussion of outcomes and policies in all Latin American countries would be difficult giving space limitations, we concentrate on a sub-set of South American countries (Bolivia, Brazil, Chile, Peru and Uruguay) that represent the diversity of the region.<sup>2</sup> All five are commodity exporters which in recent years have benefited from growing international commodity prices. As Table 1 indicates, in all cases the share of primary exports in the total has increased during the 2000s, partly as a result of growing trade relations with Asia and the Pacific. In Brazil, for example, the share of primary goods increased from 42.0% in 2000 and 63.6% in 2010 and the weight of

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1 These policies should also help decrease wage differentials between different sectors, making low productivity sectors better paid and introducing additional incentives for productivity growth.

2 We concentrate on South America as the region within Latin America that has grown faster and has experienced more policy innovations. Some Central America countries like El Salvador have recently witnessed interesting innovations but their economic conditions and external insertion in the global economy is quite different. The failure to include Argentina may seem problematic, since it is one of the largest countries in South America. However, so is Venezuela. The problem with Argentina is twofold. First, the country started off the period with a major financial crisis and secondly, policies across the decade have undergone significant changes. In any case, since our analysis focuses on a sample of diverse countries, excluding Argentina does not weaken our research design.

exports to Asia almost tripled. In 2010 primary exports accounted for 89% or more of total exports in Bolivia, Chile and Peru. Historically, three of the countries in our sample (Brazil, Chile and Uruguay) had previously been successful at import substitutions while the other two had not. Two of them (Chile and Uruguay) have a legacy of robust social policy followed by radical change (Chile) and incremental change (Uruguay but also Brazil). Peru and Bolivia did not have such legacy while Brazil had it for urban areas but not but rural (Filgueira 1998). In recent years, all five countries but Peru have also had left-of-center governments.

**Table 1: Primary Exports and Exports to Asia Pacific (% of Total Exports), 2000 and 2010**

	Primary exports		Asia-Pacific	
	2000	2010	2000	2010
Bolivia	72.3	92.6	1.4	16.3
Brazil	42	63.6	10.3	28.2
Chile	84	89.6	26.1	49.7
Peru	83.1	89.1	16.9	26.5
Uruguay	58.5	74.3	8.3	9
Latin America and the Caribbean	41.4	54.1	5.3	17.2

Source: United Nations Economic Commission for Latin America and the Caribbean (ECLAC 2011 and 2012)

Our paper has three goals: (1) to show the analytical pay-off of the concepts of social and market incorporation in evaluating outcomes and policies with a consistent measuring stick; (2) to apply both concepts to recent outcomes in a diverse set of Latin American countries; and (3) to evaluate the potential contribution of recent policy changes to future market and social incorporation and discuss additional policies that may be required in the future. In comparing different countries, we are aware of the profound differences in starting conditions in terms of social and economic development and thus concentrate on the different trajectories of change.

Our analysis shows increasing market and social incorporation in recent years in terms of outcomes and more diversity in terms of policies. Brazil and Uruguay's performance has been exceptional in both fronts, while other countries have generally advanced more in policies towards social than market incorporation. This may become problematic if/when commodity prices come down in the future and economic growth slows down.



## 2. Income Distribution and the Double Incorporation in Latin America

In any given country degrees of inequality reflect the primary distribution of income between profits and various types of wages as well as the state's capacity to redistribute resources through taxes and public spending. Sustained reductions of inequality will involve some combination of growing amounts of formal jobs, higher real wages (particularly of unskilled workers) and more state redistributive capacity.

The concepts of market and social incorporation help address these three processes. Contrary to what went on in the OECD, peripheral countries have yet to bring large proportions of their adult population on board of formal labor markets. In here we understand the latter as those involving active state regulation of key aspects of commodification such as wages and working hours. In many countries the informal economy accounts for half of the total gross domestic product and low productivity services and subsistence agriculture are still employers of last resort. The lack of incorporation to formal employment leaves many workers with low wages, vulnerable labor conditions and limited access to skill upgrading and social rights. Expanding the number of formal jobs and increasing wages for formal unskilled workers is thus a necessary condition for a sustained reduction of inequality and requires three types of changes: (a) a rapid process of structural change towards high productivity sectors (Ocampo et al. 2009; Rodrik 2011); (b) institutional changes in labor-capital relations and (c) a sustained increase in minimum wages.

Market incorporation, however, is, not a sufficient condition for the reduction of inequality. We can easily envision scenarios under which new formal jobs expand rapidly but wages of skilled workers and profits grow as fast or even faster, therefore leading to less equity. Exclusive dependence on market income will also leave low income groups exposed to unpredictable risks (e.g. accidents and sickness), to risks that are hard to cope with on individual bases such as aging and disability, and therefore to sharp reductions in living standards. This is why expanding social incorporation—that is, the decommodified access to transfers and services like healthcare, education and pensions as a matter of right, regardless of income levels is also extremely important for people's well-being. Social incorporation usually depends on three factors: (a) periodically updating social spending policy to changes in the structure of social risks (recalibration in Pierson's terms); (b) sustained increases in social spending through a wide range of means from payroll to indirect and personal and corporate direct taxes; and (c) combined criteria of targeted and non-targeted, cross-class access which

makes benefits it affordable to the poor and attractive to the middle-class (whether through radical or incremental redesign of existing arrangements).

Table 2 summarizes the individual components of market and social incorporation, identifies useful indicators, and lists policies that can help accomplish them. While the components and indicators are rather unproblematic, our proposed requirements and policies are more normative and therefore very likely more contentious. There is, however, a growing body of research that emphasizes the importance of active state intervention in terms of production, better and more secured jobs and overall social rights.

**Table 2: Market and Social Incorporation: Indicators, Requirements and Policy Dimensions that Help Meet Requirements**

Type	Indicators	Requirements	Policies
Market incorporation  (through formal, well-paid employment)	<ul style="list-style-type: none"> <li>- Increased share of formal in total jobs</li> <li>- Wage growth, particular in minimum wages</li> </ul>	<ul style="list-style-type: none"> <li>- Structural change towards sectors with higher productivity</li> <li>- Shifts in labor-capital relations</li> </ul>	<ul style="list-style-type: none"> <li>- Measures towards structural change or sectoral policy<sup>3</sup></li> <li>- Steady growth of minimum wages</li> <li>- Promotion of labor rights and collective bargaining</li> </ul>
Social incorporation  (decommodified access to social rights)	<ul style="list-style-type: none"> <li>- Increased coverage of healthcare, pensions and education</li> </ul>	<ul style="list-style-type: none"> <li>- Periodic update of social policy to changes in the risk structure</li> <li>- Stress universal policies with affirmative action through targeted measures</li> </ul>	<ul style="list-style-type: none"> <li>- Growing social spending</li> <li>- Universal measures securing more equal access to social protection</li> <li>- Targeted programs that help cover the previously unprotected population under universal policies</li> </ul>

Source: Own elaboration

<sup>3</sup> These policies are usually referred to as “industrial” policies even if they target sectors other than industry such as the service or agricultural sectors. We rather refer to these policies as policies towards structural change or “sectoral” policies.

All economic policies have an effect on market incorporation. If monetary policy is excessively focused on controlling inflation, interest rates may be excessively high and affect domestic investment and employment growth (Stiglitz et al. 2006). If fiscal policy is pro-cyclical, GDP will be below its full potential during long periods of time, affecting investment and hiring decisions (Ffrench-Davis 2010). A weak exchange rate is also important to promote exports and facilitate import substitution in the domestic market.

Yet securing market incorporation in the long run ultimately depends on creating new sectors and upgrading existing ones—particularly in services. Successful countries like Korea, Taiwan and China have been able to move a growing number of workers from the agricultural sector—where productivity was traditionally low and informality high—to high productivity manufacturing activities (Ocampo et al 2008). As Margaret McMillan and Dani Rodrik (2011: 20) put it, “where Asia has outshone [...] is not so much in productivity growth within individual sectors, where performance has been broadly similar, but in ensuring that the broad pattern of structural change contributes to, rather than detracts from, overall economic growth.” At the same time, expanding productivity in services is also a pre-condition to sustain formal job creation given the large contribution of the tertiary sector to the overall economy.

Policies towards structural change are “any type of selective government intervention or policy that attempts to alter the structure of production in favor of sectors that are expected to offer better prospects for economic growth (and good jobs we would add) in a way that would not occur in the absence of such intervention in the market equilibrium” (Pack and Saggi 2006: 1). This type of policy constitutes a fundamental tool for employment-creating structural change. Given market failures in the process of learning and knowledge creation, lack of venture capital and coordination failures of different types, the government must intervene to promote new high-productivity sectors (Amsden 2001; Paus 2012; Rodrik 2007).<sup>4</sup> They should give tax incentives and even create public companies to promote learning and innovation in either new sectors or in upgrading activities that already exist within the country.

Yet the promotion of high productivity sectors is not enough to significantly improve market incorporation, particularly in commodity exporting countries like those we address in this paper. If state intervention is restricted to high productivity sectors and links between those sectors and the rest are weak, countries end up with a large

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4 The recognition of the role of policies towards structural change for economic development is rapidly becoming part of the mainstream consensus. Even Justin Lin, Chief Economist of the World Bank, now acknowledges government subsidies and incentives as useful policy tools (Lin 2011). There is however less agreement regarding how far countries should move beyond their “natural” comparative advantages.

informal sector. This was precisely Latin America's Achilles' heel during the import substitution period. To prevent the growth of informality, states may need to promote high productivity and low productivity activities at the same time. In a recent *ECLAC Review* article, Carlota Pérez recommends "a two-pronged approach to development: top-down and bottom-up" (Pérez 2010: 122) – promotion of high productivity, capital intensive sectors like commodity production and labor intensive service activities dominated by the poor. While her bottom-up strategy concentrates on relatively modern activities, governments should also find ways to support informal companies in areas like management, accounting and use of basic technologies.

Broadly defined, policies involved in social incorporation are those that detach people's well-being from the cash nexus. They can include a broad set of redistributive measures, from infrastructure that facilitates access to water to healthcare services. Social policy, whether universal, contributory or targeted (Esping-Andersen 1990), is particularly influential for social incorporation. Universal policies reallocate resources in light of people's belonging to a community. Contributory policies reallocate resources in light of prior payments. Targeted policies follow an affirmation action criterion reallocating resources according to need. Across policy sectors and eligibility criteria, policies may aim at risk prevention (like education), while other at risk coping (like pensions) (Pribble 2010).

In terms of social incorporation, policies that expand the provision of social services to a majority of the population are likely to make a particularly positive contribution. The reason is threefold. First, whether it is schooling or healthcare, individuals from all income levels and personal characteristics end up sharing a similar treatment based on their condition as citizens. Second, the middle class is more likely to support services they benefit from – and the social spending associated with these services – whether these services are tailored for specific groups or the population at large. When the middle class supports universal policies, its mobilization capacity ends up benefiting low income groups as well. Third, this cross-class alliance is not only helpful to reach a broad access to state policy but to guarantee good quality. Thus, the resulting expansion of transfers and services in health and education would have a substantial redistributive effect thus creating a virtuous circle for social incorporation (Huber 2002; Mkandawire 2006a). In Mkandawire's words (2006b, 13), "institutions of welfare also act as intervening variables, shaping the political coalitions that eventually determine the size and redistributive nature of the national budget." This is clear in the experience of Scandinavian countries and, within the Latin America case, of Costa Rica during the period 1950-1980. During these three decades, higher social spending led to the

increase in the number of public employees, who supported a social-democratic party that favored social incorporation policies.

In many instances, the expansion of universal policies is not enough to guarantee access by low income groups. Those most vulnerable may require affirmative action to assure their effective incorporation to universal transfers and services. For instance, children from low income families may need uniforms, transport and complementary nutrition to fully benefit from free and high quality schools. Whether tied to universal measures or as stand-alone programs, reaching the previously unprotected population has been a key role of social assistance at large and, during the last decade, of Conditional Cash Transfer (CCTs) programs in particular. CCTs have also provided more groups with minimum entitlements, reaching populations that may have never benefited by state policy before. This is why in subsequent sections we consider CCTs a step in the right direction—even if an insufficient and problematic one – and assess both their scope and their coordination with universal policies.

Securing social incorporation in the long run requires not only creating universal policies but also updating social programs to the risk structure. It is not enough to devote enough social spending and to channel resources to the perfect combination between universal and targeted policies. Countries also need to adapt social policies to changing needs, whether it is aging, the feminization of the labor market, or the reduction of fertility rates, just to mention a few.

### **3. Latin American Historical Failure to Accomplish Economic and Social Incorporation**

Depicting the historical evolution of the complex and diverse processes of market and social incorporation in Latin America is beyond the scope of this paper. Yet a brief summary of the comparative record will be useful for our later discussion. Argentina, Chile, Uruguay and, to a lesser extent, Brazil were more successful in promoting economic modernization and expanding social rights during the 1950s, 60s and 70s while Bolivia, Paraguay or Peru were not (see Filgueira 2005; Martínez Franzoni 2008; Sheahan 1987; Thorp 1998 among others). Overall, however, Latin American countries failed to simultaneously secure market and social incorporation thus contributing to make the region the most unequal in the world for at least during the last century. State-led industrialization before the 1980s did promote structural change towards manufacturing and services even in small, poor economies. Nevertheless, the amount of new urban jobs was not enough to absorb the growing supply of labor, and informality increased rapidly in the service sector (Ffrench-Davis, Muñoz and Palma 1995).

Structural heterogeneity had a negative impact on social policies and contributed to segmented social incorporation. “Bismarckian” social insurance regimes created “occupationally fragmented schemes” that pivoted around formal employment and excluded the urban and rural poor (Seekings 2008: 25). With the exception of Costa Rica, social insurance led to high degrees of stratification under what Filgueira (2005) refers to as “stratified universalism”. Stratification cut across countries with high coverage nationwide (like Argentina, Chile and Uruguay) and high coverage among urban workers alone (like Brazil and Mexico). Most countries had minimum social policies under which few people have access to good quality, public services.

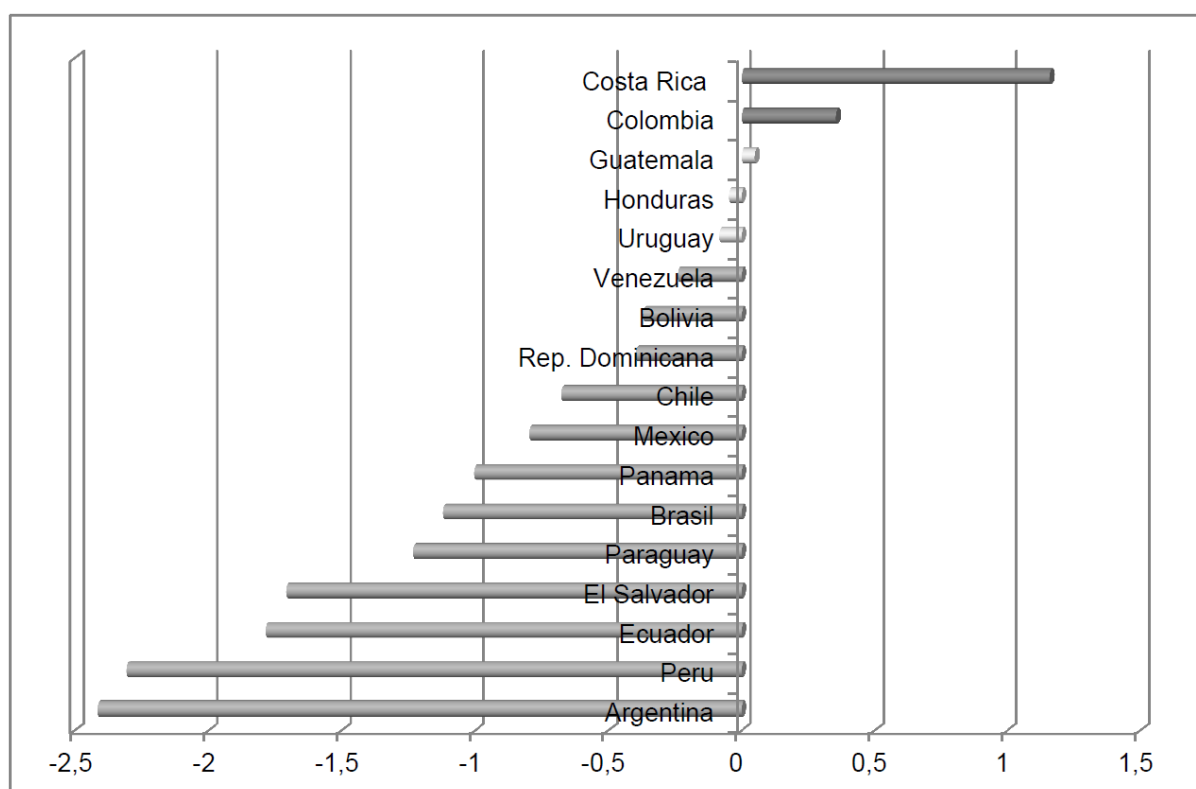
The Washington Consensus aimed to expand job opportunities through trade liberalization, the promotion of foreign direct investment and the deregulation of the economy. Proponents argued that market-friendly reforms would increase investment levels and the use of labor-intensive production techniques. At the same time, neoliberal policies aimed to reduce segmentation in the welfare system through privatization, decentralization and targeted social programs.

The results, however, were generally quite disappointing in terms of both market and social incorporation. Investment demand never expanded as fast as initially expected and economic growth remained sluggish (Ocampo 2004; Taylor and Vos 2002). Large manufacturing firms survived by reducing their employment levels and informality increased in most countries (Reinhart and Peres 2000). Meanwhile, except in countries with exclusionary welfare regimes social incorporation shrank until the 2000s. In the more liberal cases like Chile, large segments of the middle class and the poor did not benefit from the privatization of pensions and did not improve their access to health services in any significant way. In other cases like Uruguay, there were relatively limited reforms and segmentation remained.

In the last decade, and in a quite surprising fashion, income distribution has shown slight improvements.<sup>5</sup> Figure 1 presents the evolution of the Gini coefficient in most Latin American countries during the 2000s. Inequality decreased significantly in 12 of the 18 countries in the region and only increased in Costa Rica and Colombia. With the exception of Uruguay, all countries we discuss in the next section have experienced notable improvements in income inequality as reported by their Gini coefficients. Has this reduction in inequality being accompanied by improvements in market and social incorporation? Have there been changes in long-term policies? These are the questions we address in the rest of the paper.

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5 It is too early to establish causal relations between new policies and the reduction in income inequality – although some authors have tried to do so already (Cornia 2010).

**Figure 1: Latin America: Change in the Gini Coefficient; ca. 2000-2009**

Source: Own elaboration with data from the Center for Distributive, Labor and Social Studies at Universidad Nacional de la Plata (CEDLAS)

#### 4. Progress in Market and Social Incorporation Since 1995

Latin America is a rather diverse region. To take into consideration such diversity, in the next two sections we discuss the trajectory of a small set of contrasting countries: Bolivia, Brazil, Chile, Peru and Uruguay. During the last decade four of the five countries have experimented with heterogeneous left-turns (Cameron and Hershberg 2010) while Peruvian administrations remained in the hands of center-of-right administrations.<sup>6</sup> Thus Peru constitutes somewhat of a control case for whether ideological changes of parties in office influence market and social incorporation—even if in here we are not considering driving forces or drawing causal relations between politics and the outcomes we are interested in.

Below we assess performance in market and social incorporation based on well-established and available comparative indicators and statistics. In all cases, cut off

<sup>6</sup> The four left-wing countries represent different political styles and have implemented different policies. Yet along with Cameron and Hershberg and the various contributors to their edited volume, we subscribe to a non-dichotomist view of the left (Cameron and Hershberg 2010). Our analysis thus avoids divisions of the left between a social democratic “good” one and a “radical” bad one — an approach partly adopted, for example, in Weyland, Madrid and Hunter (2010).

values to establish changes in market and social incorporation are relative (i.e. depend on the specific context and consider the starting point for each country) rather than absolute. We take 1995 as the starting point for our analysis, but concentrate on the period 2000-2009 when new governments came to power and external conditions were particularly positive for economic growth.

#### **4.1 Market Incorporation**

In the last decade and after years of weak performance, all countries considered expanded market incorporation.<sup>7</sup> In Table 3 wage earners are presented as a proxy measure to formal employment while non-professionals, technical and administrative positions as a proxy measure to informal jobs. Under wage earners, we include those working in micro firms (with less than five employees), who are usually more vulnerable than workers in larger business.

During the period 2000-2009 the share of wage earners, a proxy measure for formal employment, increased in all countries. The percentage of wage earners among the urban working population increased by around three percentage points in Brazil and Chile, by five in Bolivia and by more than six in Peru (Table 3). Uruguay constitutes the only exception but even there the percentage of non-professional self-employed and domestic workers also decreased significantly.

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<sup>7</sup> We use data from the International Labor Organization (ILO), which is based on household surveys that are not strictly comparable among countries — although analysis of trends may be less problematic. Although data for 2010 and 2011 is not available, by including 2009 we are able to capture the impact of the global financial crisis. The good numbers in that year clearly demonstrate South America's impressive resilience to that external shock.



**Table 3: Share of Working Population per Type of Job in the Urban Sector (% of Total), 1995, 2000 and 2009**

	Wage earners		Non-wage earners		Domestic workers
	Total	Workers in companies with 5 or less workers	Total	Non professionals, technical and administrative roles	
<b>Latin America</b>					
2000	60,7	13,5	27,4	20,8	8,2
2009	63,2	13,0	26,2	19,9	7,8
<b>Bolivia</b>					
1995	45,0	11,7	37,4	28,5	5,4
2000	44,5	10,8	43,5	38,2	4,2
2006	49,4	12,9	38,1	29,1	4,0
<b>Brazil</b>					
1995	58,6	13,4	28,3	22,2	8,6
2001	59,8	13,6	27,8	21,3	8,8
2009	63,5	12,9	25,8	19,6	8,4
<b>Chile</b>					
1996	70,4	10,2	22,7	17,1	6,1
2000	65,2	7,7	27,6	23,1	5,0
2009	68,3	7,4	26,0	21,8	4,1
<b>Peru</b>					
1995	52,6	19,5	36,4	28,3	4,7
2000	49,9	13,2	39,1	30,4	5,3
2009	56,2	14,3	35,2	26,9	5,6
<b>Uruguay</b>					
1997	65,4	11,3	25,5	18,7	6,9
2000	64,3	10,4	25,5	17,5	8,7
2009	64,3	9,2	26,3	14,6	7,8

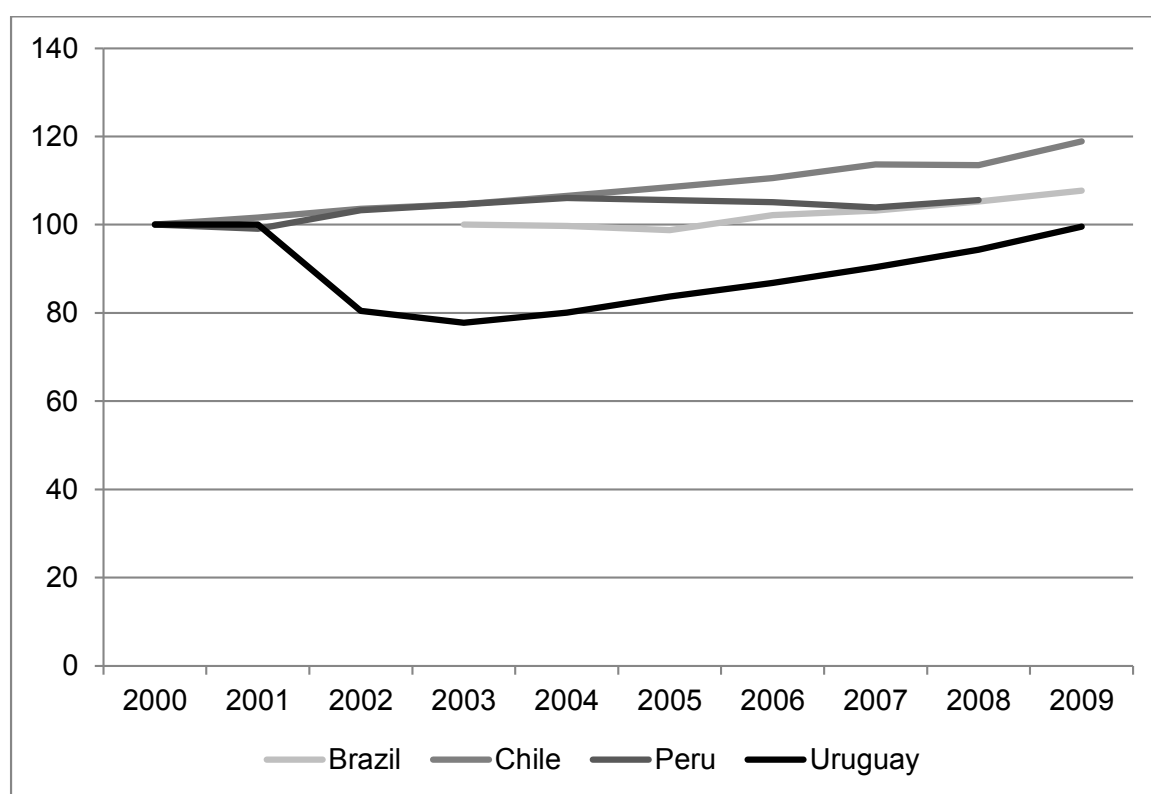
Source: Own calculations with data from the International Labor Organization (ILO 2010)

There is a clear contrast between the positive performance of the 2000s and the poor performance of the previous decade. Between 1995 and 2000—year in which the

region was in the midst of a recession—formal employment decreased in four of the five countries considered. With a reduction in five percentage points in the share of wage-earners, Chile’s performance was particularly disappointing. By 2009, Chile still had more informality than fourteen years before.

The growth in formal employment went hand in hand with the expansion of average real wages. Figure 2 and Table 4 present the average earnings from 2000 to 2009, as well as from 2003 and 2009 (to consider exclusively the recent expansionary years). In two countries (Peru and Uruguay), real average income first dropped, largely due to slow economic growth, to recuperate afterwards. Growth has been particularly impressive in Uruguay between 2003 and 2009 and Bolivia between 2003 and 2006 (Table 4). Peru’s performance, on the other hand, has been quite erratic and overall disappointing. Regrettably data on average real wages is not available for Bolivia.

**Figure 2: Real Average Earnings, 2000-2009 (2000 = 100)**



Source: ILO (2010)

**Table 4: Selected Countries. Real Average Earnings, Levels and Annual Average Growth, 2003-2008 (2000 = 100)**

Countries	2000	2003	2009	Annual rate of growth 2000-09	Annual rate of growth 2003-09
Bolivia	ND	ND	ND	ND	ND
Brazil	ND	100.0	107.7	ND	1.25
Chile	100.0	104.6	113.7	1.44	1.40
Peru <sup>8</sup>	100.0	104.6	101.0	0.12	-0.70
Uruguay	100.0	77.8	99.6	-0.04	4.21

Source: Own calculations with ILO (2010) data. See ILO methodological notes for different countries

## 4.2 Social Incorporation

Against the backdrop of previous retrenchment and emphasis on macroeconomic stability as the best social policy, all progressive governments run on promises to increase social spending and to look after people's social needs. Consistent with these promises and regardless of actual explanatory factors, during the 2000s social incorporation has increased. This is clearly reflected in coverage of various policies as the most adequate proxy to social incorporation.

Drawing from ILO data, Table 5 shows pensions and/or health coverage. Data are available for Latin America as a region as well as for all five countries considered in here but Bolivia. During the 2000s, increases in coverage were impressive across the region, particularly in the informal sector. Between 2000 and 2009, the percentage of non-wage earners with access to pension and/or health benefits increased from 28% to 47%, and domestic workers with access to these services went from 30% to 44%.<sup>9</sup> Improvements in Chile and Peru were particularly significant while Uruguay was the only case showing no gains in coverage. This is, however, to be expected in a country where by 2001, 96% of the population already had access to social insurance.

<sup>8</sup> Data for 2008.

<sup>9</sup> Non-wage earners in ILO statistics include firm owners and autonomous workers. Their data is based on household surveys.

**Table 5: Working Population with Social Security (Health and/or Pensions), % of the Specific Group; 1995, 2000 and 2009**

	Total in the country	Wage earners		Non-wage earners		Domestic workers
		Total	Companies with 5 or less workers	Total	Self-employed and independent family workers	
<b>Latin America</b>						
2000	54.5	71,5	32.9	28,4	21.7	30.8
2009	66.3	79,3	49.6	47,6	39.5	44.5
<b>Brazil</b>						
2001	58.3	74,2	39.2	38,3	27.8	35.6
2009	65.0	80,5	47.4	40,8	31.1	39.2
<b>Chile</b>						
2000	89.7	94,8	86.9	80,1	74.6	91.2
2006	93.9	96,8	92.1	89,0	85.3	95.0
<b>Peru</b>						
2000	36.6	53,8	14.7	22,7	18.5	16.8
2009	45.3	58,8	26.3	31,0	27.0	24.4
<b>Uruguay</b>						
2001	96.9	98,5	95.9	93,6	92.8	96.6
2009	96.4	98,1	93.2	92,3	91.2	96.9

Source: Own calculations with data from ILO (2010) – see ILO for methodological notes on different countries

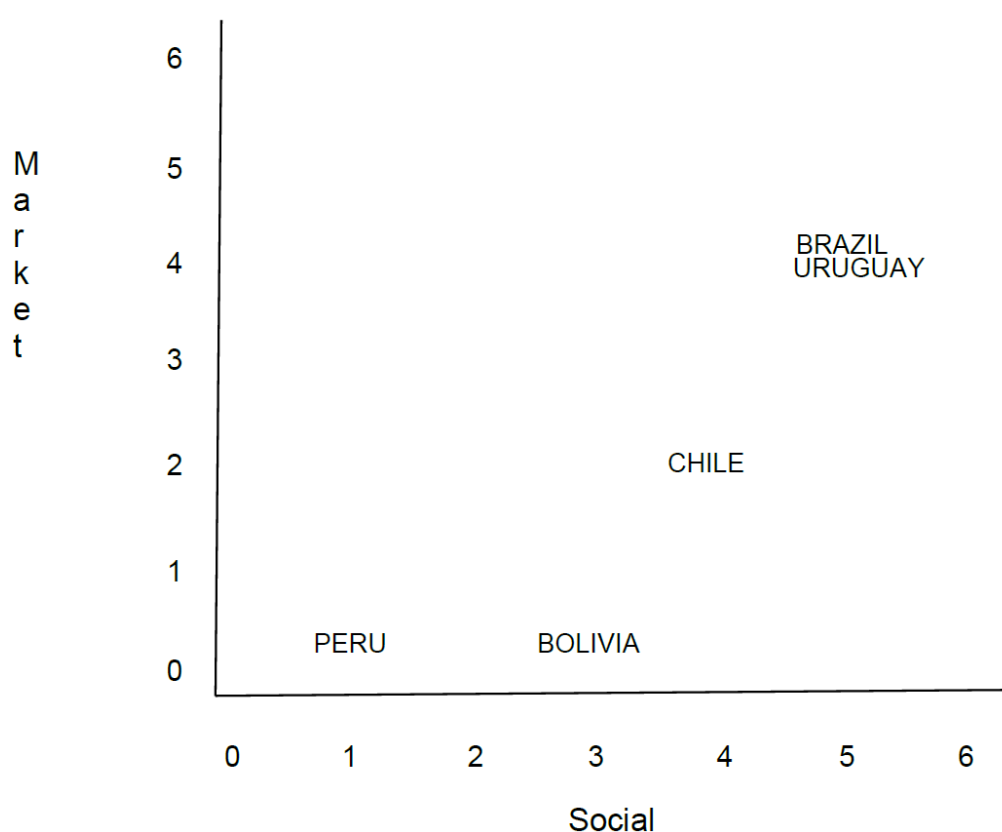
Nevertheless, there are some caveats to this overall assessment. First, improvements in Chile and Peru were just enough to recuperate the losses of the late 1990s. The case of Peru is particularly dramatic: between 1995 and 2000 overall coverage decreased from 45% of the working population to less than 37%. Second, overall levels in the informal sector are still quite low in many countries. By 2009, just 40% of self-employed and family workers in Latin America benefited from health and/or pensions public insurance. Third, these figures do not tell us anything about the type and quality of healthcare services and/or pension insurance that people receive and the disparities in entitlements among individuals.

## 5. How Sustainable Are These Improvements? A Look at Policy Change

Any attempt to assess changes in economic and social incorporation by looking at short term outcomes faces two shortcomings. First, commodity-based economic growth is an intervening factor largely dependent on external factors. Second, it is really too soon to account for transformations that started unfolding just a few years ago. In order to consider how sustainable changes are in the long run, it is thus important to consider the extent to which policies to promote the double incorporation have changed. Policies rather than outcomes can shed light on whether countries may meet the requirements involved in sustainable economic and social incorporation in the future. These policies can be diverse and will necessarily reflect a combination of historical legacies and contemporary policy formation.

Figure 3 places countries based on how much policies have improved over the past decade in terms of market and social incorporation in the five countries we are considering. Criteria to place each country in the graph draws from assessing progress made by all three policy dimensions considered under market and social incorporation, respectively. Below we explain how we measured and coded each dimension.

**Figure 3: Policy Change in Market and Social Incorporation in our Sample**



Source: Own elaboration

## 5.1 Market Incorporation

Table 6 presents all three policy dimensions evaluated to assess market incorporation, along with our criteria for coding how well each country performs regarding each dimension. Each policy dimension ranges from 0 to 2 in light of the criteria explained in the table. The overall index ranges from 0 to 6.

**Table 6: Coding of Policy Dimensions towards Market Incorporation**

<b>Policies</b>	<b>Measurement</b>	<b>Brazil</b>	<b>Bolivia</b>	<b>Chile</b>	<b>Peru</b>	<b>Uruguay</b>
1. <b>Measures towards structural change</b>	Absence (=0), timid (=1) or clear (=2) presence of industrial policies	2	0	1	0	0
2. <b>Steady growth of minimum wages</b>	Minimum wage growth over growth of per capita GDP (0 for no growth, 1 for growth below GDP per capita and 2 for growth above GDP per capita)	2	0	1	0	2
3. <b>Promotion of labor rights and collective bargaining</b>	Passage of laws and increased guarantees (0 for no laws and 2 for significant laws)	0	0	0	0	2
<b>Total index (range of variation 0 to 6)</b>		<b>4</b>	<b>0</b>	<b>2</b>	<b>0</b>	<b>4</b>

Source: Own elaboration

Few Latin American countries have implemented the kind of policies towards structural change that may be useful to enhance employment-creating structural change or the regulatory policies that can modify labor-capital relations in a meaningful way. Even relatively successful cases like Brazil and, to a lesser extent, Chile and Uruguay have focused most of their efforts in high-productivity, capital-intensive sectors and/or have lacked clear policy direction.

Following reluctant liberalization, Brazil has more recently developed active industrial policies and increased the minimum wage. Sectoral policies have had three pillars: promotion of learning and innovation, investment in infrastructure and expansion of credit by the Banco Nacional de Desenvolvimento Econômico e Social (the National Bank for Economic and Social Development, BNDES).

Following a less interventionist approach under the center-right Cardoso administration, since 2002 the center-left Lula administration adopted an increasingly aggressive industrial policy to promote large national firms. Two policy statements signalled Brazil's new approach (Doctor 2009): the Política Industrial, Tecnológica e de Comércio Exterior (Policy for Industry, Technology and Foreign Trade, PITCE) from 2003 and the Plano de Desenvolvimento da Produção (Production Development Plan, PDP) from 2008. The PITCE concentrated on learning and innovation and proposed a series of steps to create a national system of innovation. New incentives were created with particular attention to strategic sectors like semiconductors, pharmaceutical and chemical products, software, energy and capital goods.

In 2004 the Lula administration created the Agência Brasileira de Desenvolvimento Industrial (ABDI, National Agency for Industrial Development) to coordinate efforts in innovation, research and industrial development (Arbix and Martin 2010). New laws for innovation and other areas were approved and the government put more emphasis on promoting research and development at the firm level. The creation of new institutions has gone hand in hand with the expansion of public resources. In just two years, the budget of the Ministry of Science and Technology increased by 34% from US\$ 2.3b in 2007 to US\$ 3.5b in 2009. According to data from Arbix and Scott (2010), the total public expenditure in science, technology and innovation—including scientific activities and related techniques—went from US\$ 14.3b in 2000 to US\$ 43.4b in 2008.

Brazil's new approach to industrial policy has focused on innovation in knowledge-intensive sectors or on activities where the country has comparative advantages. Companies like Petrobras or Vale in oil and mining, for example, have received ample support and are expected to become global competitors in high tech activities within their sectors (Singh and Massi 2011). This is a sensible strategy but one that is unlikely to create a substantial number of well-paying jobs. Instead its impact on market incorporation is expected to be indirect: by creating linkages with other activities and generating foreign exchange, they should promote economic growth and demand in other sectors. The extent to which capital intensive sectors lead to overall market incorporation even through these indirect means, however, should be called into question.

The new approach to industrial policy has also the potential to benefit small and medium enterprises (SMEs), where a large share of formal employment concentrates.<sup>10</sup> SMEs can benefit from many of the newly created incentives, including the tax subsidies on research and development, access to government purchases and subsidies to high tech incubators. The Brazilian government also created a law for micro and small firms in 2006 to rationalize all the existing incentives targeting micro and small firms, maintained other standing programs and promoted cooperation between groups of firms at the regional level. Nevertheless, policies towards SMEs in Brazil still have significant shortcomings: they tend to treat all SMEs in the same way; they focus on companies that already have some potential and offer little long-term support for micro firms in traditional sectors; and they fail to adopt a systemic and coherent approach (Crocco and Santos 2010).

Probably even more important for employment growth and market incorporation was the Programa de Aceleração do Crescimento (Growth Acceleration Program, PAC) introduced in 2007 under the supervision of the Dilma Rousseff (now the President). The PAC committed the government to spending more than US\$ 200b in four years for infrastructure projects like road construction, urban regeneration and new houses for disadvantaged groups—all labor intensive activities (ILO 2010). In 2010 a PAC 2 was announced. It committed the government to spend US\$ 526b between 2011 and 2014 with concentration on urban infrastructure, housing, sanitation and electricity, renewable energy, oil and gas and highways and airports.

The BNDES constitutes the third pillar of Brazil's policy towards structural change and economic transformation. The BNDES participated in the design of the PITCE and committed substantial resources to new sectors. Between 2004 and 2006 alone, BNDES disbursements represented 13.3% of gross capital accumulation and 8.3% of total credit from the Brazilian financial system (Hermann 2010). In the subsequent years, disbursements increased even faster. While most loans are allocated to promote the internationalization of large firms, the BNDES also has a number of smaller programs in support of SMEs.

Although no other country has advanced as much as Brazil in the development of new industrial policies, some of Chile's efforts should also be acknowledged. During the 1990s, horizontal policies that confronted market failures in all economic sectors were dominant. The government paid particular attention to the promotion of exports through schemes like tax reimbursements and export credits—typical instruments of

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<sup>10</sup> In 2005, micro and small firms accounted for 52% of total formal employment (Crocco and Santos 2010) and an even larger percentage of informal employment.



what Shrank and Kurtz (2005) have called “open industrial policy”. These measures complemented the work of the Fundación Chile, which is a non-profit organization created in 1976 and run jointly by the government, IT&T and (since 2006) BHP Billiton. Fundación Chile funds innovations in six natural resource-based sectors and also acts as a sort of venture capital firm; it succeeded in creating a salmon industry in Chile and is now involved in important projects in solar energy production and other sectors (Agosin, Larrain and Grau 2010). The first Concertación government in 1990 also implemented explicit policies to support SMEs, including subsidies to promote collaboration between firms and several lending programs (Belmar and Maggi 2010). Yet spending on production promotion was low (just 0.5% in 2003); there were too many different programs (125 in 2005 with almost 100 of them for SMEs); and targeted policies to promote either specific high productivity sectors or particularly backward companies were missing.

The government stepped up its efforts to develop vertical policies that concentrated on winning sectors in the early 2000s. The Corporation for the Promotion of Production (Corporación de Fomento de la Producción, CORFO) created a new subsidy program to promote foreign investment in high tech activities like software, semiconductors, back office and other ICT services. During the 2000s the Chilean government has also implemented more aggressive learning and innovation policies, including new incentives for university-firm collaboration and the creation of National Council of Innovation for Competitiveness (NCIC).

Yet Chile’s industrial policy still concentrates on further developing traditional comparative advantages and has little focus on employment—a primary requirement to secure market incorporation in the long run. Agosin, Larraín and Grau (2010) argue that industrial policies are still residual: there is insufficient spending, simultaneous initiatives are way too many and there is no strong, coordinated institution. Lending programs are also small. CORFO’s GIF lending program—which concentrates on small and medium firms—managed only 1.1% of the total portfolio of the Chilean financial system in 2006, well below Mexico’s NAFIN (9.7%) and Colombia’s BANCOLDEX (5.3%). While recognizing the shift in Chile’s policy approach in recent years, Pérez Caldentey (2011) is even more critical based on evidence that shows an increasing turn to natural resources and inability to promote structural change. Chile lacks strategies to promote economic upgrading beyond natural resources and to increase formal employment in non-tradable sectors.

Economic policy has differed sharply in Bolivia and Peru. Since 2001 under the right-of-center Toledo and Garcia administrations, Peru maintained a neoliberal stand based

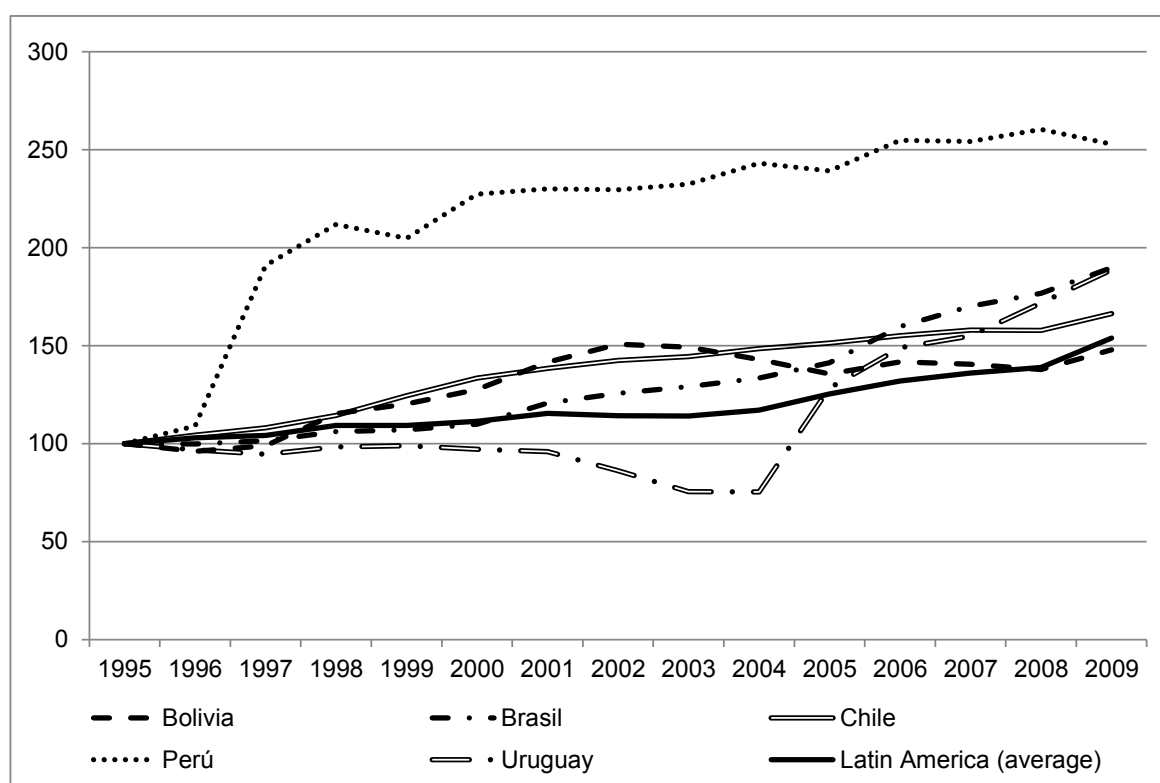
on the attraction of foreign direct investment in mining and other natural resources (Tanaka and Vera 2008). In Bolivia, on the other hand, the Morales administration increased royalties and taxes in the hydrocarbon sector significantly and tried to expand the state's production capacity (Kohl 2010). Yet in many ways the Bolivian and Peruvian approaches to industrial policy share similar shortcomings. The combination of weak public institutions and high commodity prices against the background of a long-term dependence on natural resources have limited the ability to promote structural change and new drivers of employment. In Peru, most policies have aimed at further liberalization and creating a more "effective" business environment (Tello and Tavera 2010). Public spending in research and development is very low: in 2009 Peru spent 0.16% of GDP compared to 0.54% in Latin America as a whole and 1.5% in China (Tavera 2010). The Toledo administration did create a new institutional architecture to promote small and medium firms, including a new department in the Ministry of Labor and a new law (Villaran 2010), but the lack of coordination and of funding remained a problem. By 2007 micro and small firms received an average of US\$ 3.4 in various subsidies—equivalent to just 0.4% of total production (Tello and Tavera 2010). In Bolivia, the government committed to add value to the gas industry and achieve economic diversification but no policy adoption seems to have yet taken place (Kaup 2010, Kohl 2010; Webber 2009).

After years of neglecting the promotion of structural change, starting in 2005 with the left-wing administrations of Vázquez and Mujica, Uruguay adopted a more aggressive stand. Uruguay has begun to promote collaboration between different ministries, created new institutions to promote learning and innovation (i.e. National Agency for Research and Innovation) and implemented new tax subsidies to promote private investment, cluster development and learning and innovation (Barrios, Gandelman and Michelin 2010). Investment incentives depend on meeting a series of performance requirements, including the creation of full time employment and the signing of collective agreements which are not usually found in other countries. Nevertheless, most incentives are still channelled to agricultural products and natural resources with limited employment potential and policies towards structural change still play a minor role in the country's overall public policy agenda—reasons that justify our low mark in Table 2.

Uruguay is, on the other hand, a leader in the promotion of labor rights and collective bargaining. The Vazquez administration re-established the Wage Councils, a tripartite forum for the negotiation of wages created in 1985 but inactive during the following two decades (Chasqueti 2007). A 2005 decree re-enacted the Councils for the private sector and created new ones for the public and rural sectors. Negotiations have been generally fruitful: between 2005 and 2008 there were 628 collective agreements, more

than four fifths reached by consensus (Méndez, Senatore and Traversa 2010). Between 2005 and 2006 the government also approved eleven new laws that strengthen labor rights, including the regulation of paid domestic employment, the promotion of trade unions rights and the establishment of maximum working hours per day among rural workers. The Uruguayan government has also aggressively expanded the minimum wage: between 2003 and 2009 it increased by an annual average of 16% compared to 5% in Latin America as a whole (Figure 4).

**Figure 4: Real Minimum Wages, 1995-2009 (1995=100)**



Source: ILO, *Panorama Laboral*, various years

Efforts to influence capital-labor relations and strengthen trade unions have been relatively absent in the other countries. Even in Brazil, where the ruling Partido dos Trabalhadores (Labor Party, PT) had close historical ties with trade unions, the government has done relatively little to promote collective agreements and recuperate traditional corporatist regimes. Instead, the PT's wage policy has promoted a continuous expansion of the minimum wage, which grew by an average rate of 6.7% between 2003 and 2009. Higher minimum wages exert an upward pressure on other wages in the formal sector and has also had positive effects on pensions and other social benefits. In all other countries considered in the analysis but Uruguay, the evolution of minimum wages was rather disappointing for market incorporation.

## 5.2 Social Incorporation

Overall, during the last decade, Latin American governments have adopted a new set of policies that are more ambitious and, in many cases, more sensitive to social incorporation. Reygadas and Filgueira (2010) echo this positive evaluation in their review of the social policies that left-wing governments have adopted in recent years. These include maintaining and expanding social assistance programs inherited from the retrenchment period, particularly CCTs, as well as creating a broad array of programs, from social-democratic measures aiming at equalizing capacities such as Uruguay's "Equity Plan" and Chile's "AUGE" healthcare program, to radical measures that directly intervene in markets such as nationalizations in Venezuela and Bolivia, the land reform in Brazil and various types of subsidies and price controls in several other countries.

Table 7 addresses the three policies presented earlier in Table 1, namely growth of public social spending, universal policies seeking more equal access to social protection, and targeted policies that reach previously unprotected population. Overall, gains in social incorporation reflect increases in per capita social spending, re-reforms of health and pension and the expansion, redesign or creation of new social assistance programs. In the same way as we did concerning market incorporation, Table 6 presents all three policies evaluated to assess social incorporation, along with our criteria to code how well each country performs regarding each dimension. Just as with our index for market incorporation, each policy dimension ranges from 0 to 2 in light of the criteria explained in the table. The overall index ranges from 0 to 6.

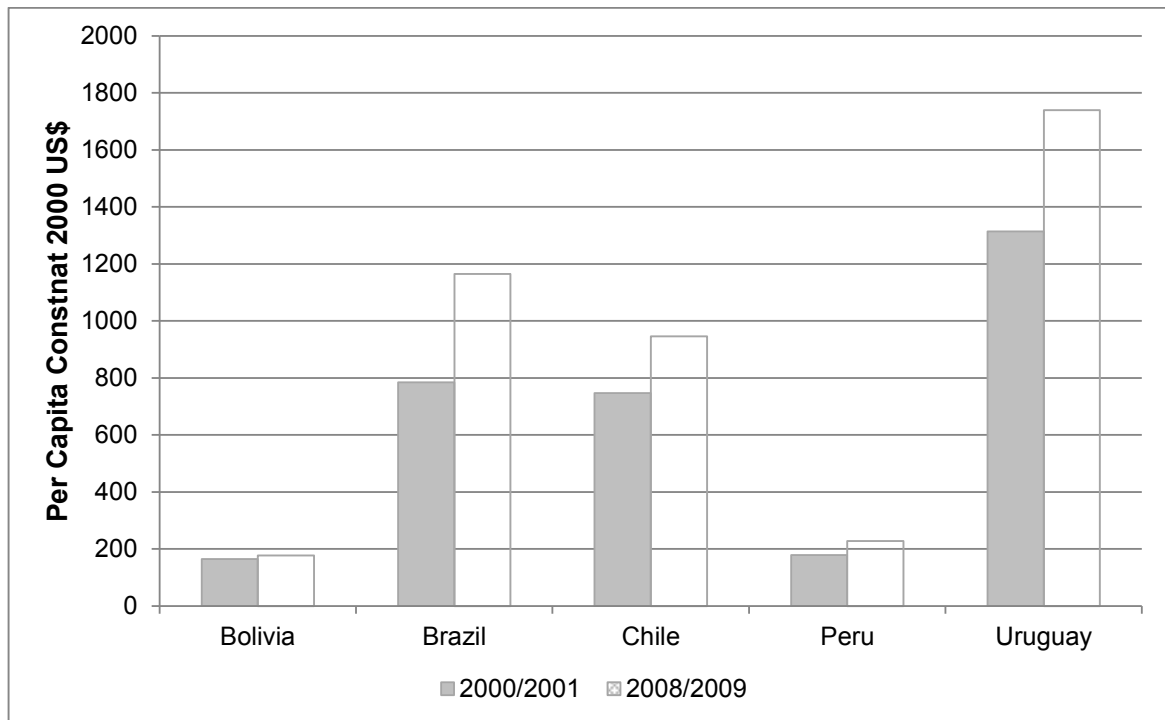
**Table 7: Coding of Policy Dimensions towards Social Incorporation**

<b>Policies</b>	<b>Measurement</b>	<b>Brazil</b>	<b>Bolivia</b>	<b>Chile</b>	<b>Peru</b>	<b>Uruguay</b>
1. <b>Growth of state-led social protection</b>	Permanence (=0), slight (=1) or considerable (=2) increase in per capita social spending over growth in per capita GDP	2	0	1	0	2
2. <b>Universal policies seeking more equal access to social protection</b>	Level of sectoral reforms towards universalism; none (=0); only healthcare or pensions (=1); both healthcare and (=2) pensions	1	1	2	0	1
3. <b>Targeted policies reach previously unprotected population</b>	Non adoption of CCTs (=0); little coverage (=1) or massive coverage (=2)	2	2	1	1	2
<b>Total index (range of variation 0 to 6)</b>		<b>5</b>	<b>3</b>	<b>4</b>	<b>1</b>	<b>5</b>

Source: Own elaboration

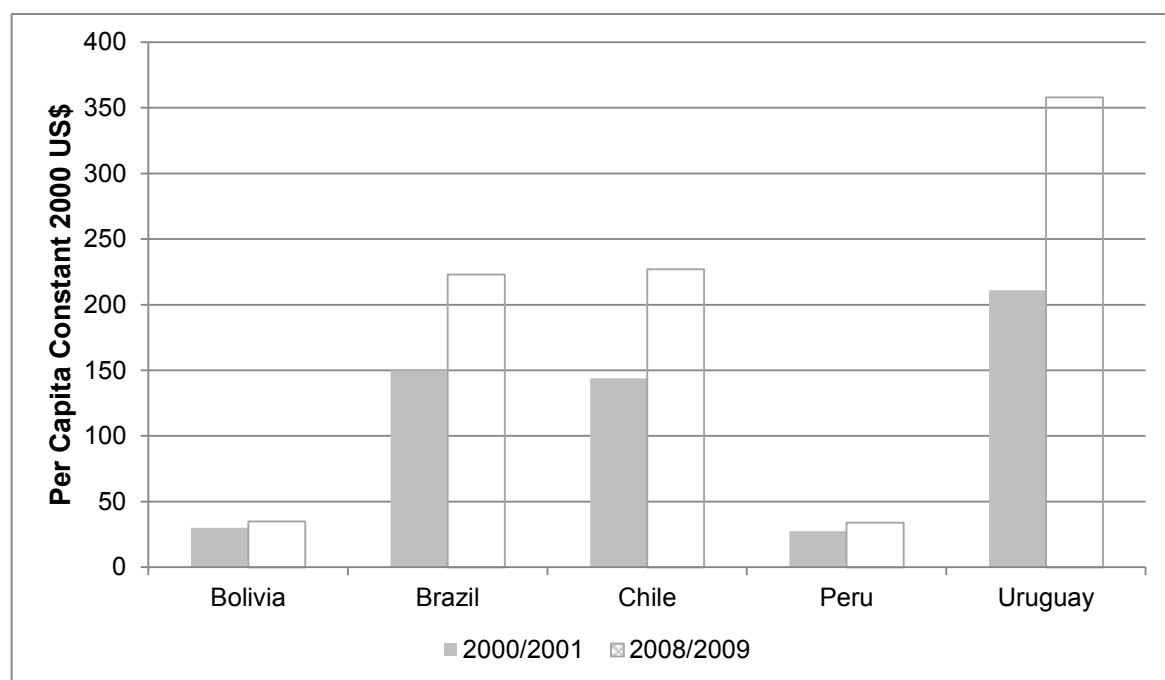
To address social spending, Figures 5 and 6 show levels of per capita social spending overall and in healthcare during the 2000s. Brazil's performance was particularly impressive: between 2000-01 and 2008-09 total spending per capita increased by 48%, going from US\$ 785 to US\$ 1165 (in real terms) while health spending also expanded at a similar rate. To the contrary, in Peru and, especially, Bolivia, total spending per capita increased well below GDP per capita growth (8% versus 19% in the case of Bolivia, 28% versus 43% in the case of Peru). This said, increases in social spending say nothing about how regressive or progressive, exclusive or inclusive, social spending is.

**Figure 5: Public Social Spending (in Per Capita Constant 2000 US\$), 2000/2001 and 2008/2009**



Source: Own elaboration with data from ECLAC (2010)

**Figure 6: Public Spending in Health (Per Capita Constant 2000 US\$), 2000/2001 and 2008/2009**



Source: Own elaboration with data from ECLAC (2010)

Increases in social spending could be reflecting a regressive allocation of resources. In other words, a few people could be getting the bulk of benefits of the new programs. As a result, we need to pay even more attention to the composition of social spending and the reform in the largest programs like pensions and healthcare. Three of the five countries studied in here, Brazil, Chile and Uruguay, have undergone changes towards more universalism in access and benefits regarding pensions and healthcare.<sup>11</sup> Healthcare but not pension reforms were introduced in Bolivia, while Peru transformed neither sector.

Let us start this discussion with the Brazilian case. Brazil began its health and pensions reform already under the Cardoso administration and continued under Lula. Advances have been incremental in nature and slow in pace, due to the power of organized groups with vested interests in pre-existing arrangements of social protection and human capital formation (Hunter and Sugiyama 2009). The outcome has been a gradual move towards raising minimum living standards among population groups previously excluded from state intervention along with the maintenance and expansion of entitlements for the better off which, in turn, has inhibited much progress towards reducing inequality. In pensions, this occurred mostly because reforms did not alter benefits among particular occupational groups. In healthcare, this occurred because the better off exit or stay away from the newly created Unified Healthcare System. As a result, Brazilian social incorporation has taken place through expanding a basic floor of social protection rather than by shortening the distance between higher and lower income groups.

Differences between pension and healthcare reforms are also noteworthy. In pensions, the Lula administration sought to tighten requirements (like the minimum retirement age) and redefine entitlements (like benefits for economically dependent family members) while also taxed the benefits of the most affluent population. It did not change the segmented architecture of the system but intervened in the parameters defining requirements and benefits. In healthcare, the reform was more fundamental and established a national healthcare system aimed at reaching the overall population. This involved a major change in the architecture of the system yet it fell short in reforming private provision. Still, both reforms entailed important steps in the right direction.

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<sup>11</sup> Mesa-Lago's (2007) comprehensive assessment of reforms involves six dimensions: coverage, benefits, equity, sustainability, efficiency and social participation. The former three dimensions directly relate to people's well-being while the latter three to managerial matters. In here we are mostly interested in coverage, benefits and equity. Since we are not assessing each reform in substantive terms (i.e., whether healthcare services are all people should receive) we combine benefits and equity as part of a single dimension that tackles people's access to equal benefits.

The two socialist administrations of the Chilean Concertación took some steps towards universalism with the creation of basic health entitlements for the population at large through the Plan for Universal Access with Explicit Guarantees (Plan de Acceso Universal con Garantías Explícitas, Plan AUGE). The AUGE plan created a universal mandate of services that every health insurer is obliged to provide within explicit timelines, thus stopping the practice of ISAPREs offering plans that omitted key services, such as reproductive health care for women (Dávila 2005; Ewig 2008). Such services are incrementally expanded and selected based upon their cost-effectiveness in preventing death and disability (Ewig and Kay 2011). New benefits have been added only when it has been fiscally possible to pay for additional pathologies (Biblioteca del Congreso Nacional 2002 in Ewig and Kay 2011). In addition to the AUGE bill (passed as Ley 19.996 of September 2004), three additional bills were introduced: two of which would provide more regulation over the ISAPREs and a third, the Sanitation Authority Law (Ley de Autoridad Sanitaria), which would give hospitals greater autonomy.

The 2008 pension reform maintained private individual accounts as the core of the pension system while introducing a new redistributive benefit program, a Basic Solidarity Pension (Pensión Básica Solidaria). The basic pension can reach up to \$160 per month and involves a public subsidy to households earning up to 60% of the income scale, and which increases as contributions decrease. The reform also includes a bonus for each live birth for women, therefore acknowledging time devoted to child-birth and child-rearing (Ewig and Kay 2011).

In January of 2008 Uruguay launched an Integrated National Healthcare System.<sup>12</sup> This system brings together, previously fragmented and uncoordinated public and private (mutual, collective, not-for profit) systems with unequal access and services. Before the reform, the poor mostly relied on the former, while the middle-class relied on the later either due to mandatory social insurance for workers or to voluntary affiliation among the non-active population. With the reform, the population at large (not just private workers as before) makes contributions according to their income to the National Healthcare Fund, a core aspect of the reform, rather than directly to providers. Insurance reaches the active population, retired workers and economically dependent family members (children and spouses). Healthcare providers receive resources from the National Fund according to their risk (rather than per insured person as before), therefore eliminating adverse selection of people with more income and lower risk. Altogether, these measures expand coverage and universalize access regardless of income levels. In addition the reform strengthens primary care and establishes what are guaranteed services that must be ensured to everyone regardless of provider.

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<sup>12</sup> Depiction of the Uruguayan healthcare reform is based on Borgia 2008; Pérez 2009; Setaro 2010.



Behind these transformations lie changes in healthcare delivery, management and financing.

In pensions, while maintaining the system of individual savings, in 2009 the Frente Amplio “expanded access to public benefits while keeping the defined contribution system of individual pension fund accounts intact” (Ewig and Kay 2011: 36). The reform included a reduction in the minimum age for early retirement, reduced the minimum years of contribution and created more generous pension formulas. Women also received recognition for the period spent raising children.

In Bolivia under the Morales administration the state took over contributory pension funds and eliminated the two private businesses previously in charge of these accounts, in addition to diminishing the retirement age and creating a reduced contributory pension for people with at least ten years of contribution. The administration also created a minimum non-contributory pension set as a 70% of the national minimum salary (in 2010 US\$ 66). To this purpose, the Morales administration re-named the old Bonasol universal pension program “Renta Dignidad”, expanded it to reach a broader swath of Bolivians, and increased the monthly benefit by 25% (Müller 2009 in Ewig and Kay 2011).

In addition to healthcare and pension reforms, CCTs have been created in all six cases although with very different characteristics, resources and coverage (Reygadas and Figuera 2010). Brazil’s Bolsa Familia is the largest and most successful CCT program in South America. It benefits more than 12 million households who receive a monthly check between US\$ 20 and US\$ 152 (based on 2010 exchange rates). The program expanded significantly during the Lula administration and has contributed to the rapid reduction in poverty and inequality that Brazil has experienced. Although Bolsa Familia has not eroded the unequal structure of Brazil’s social spending (Hunter and Sugiyama 2009), it has reached millions of people that previously lack all social protection.

In Bolivia CCTs also occupy a central role in the reorganization of social policy. The Morales administration created two different cash transfer programs: the Bono Juancito Pinto and the Bono Juana Azurduy. The former was launched in 2006 and gives a subsidy of US\$ 28 to every student in primary school (Yañez, Rojas and Silva 2011). It covers 17% of the total population and represents a total spending of 0.33% of GDP (ECLAC 2010). The latter was just introduced in 2009 to reduce infant mortality. It consists of small cash transfers to pregnant women and families with children under two if they attend regular health checkups.

Chile and Peru devote very little resources to CCTs (0.10% and 0.14% of the GDP) and reaches 6.8 and 7.6% of their total population, respectively (ECLAC 2010). However, the Chilean program is part of a larger set of social assistance programs and seeks to specifically target the extreme poor with access to various services and a small cash transfer (US\$ 6 – US\$ 20), which is not the case of the Peruvian program.

In the last decade, Latin America has thus taken steps towards expanding social incorporation. The promotion of structural change has been more timid, probably because it is harder and takes more time. Yet the long term sustainability of the current social model may ultimately depend on the transformation of the economic system—as the experience of countries like Costa Rica seems to illustrate (Martínez Franzoni and Sánchez-Ancochea 2013 forthcoming).

## **6. Conclusions: Summary, Prospects and Challenges**

After decades of disappointment, in recent years Latin America has shown positive improvements in market and social incorporation. Formal employment has increased in all countries and coverage in social programs has also expanded. South America even succeeded in protection formal jobs and social spending during 2008 in the midst of one of the worst global crisis in the last century.

Our paper has proposed a new way to evaluate recent policy trajectories in Latin America and think about future requirements. This framework can contribute to overcoming sterile debates about populist policies and „good“ and „bad“ left governments in the region. At the end, different governments should not be evaluated by their rhetoric or just their macroeconomic performance but primarily by their ability to promote market and social incorporation simultaneously in the long run.

Based on the proposed tool to assess progress towards market and social incorporation, we have shown, first, that progress has indeed taken place and, second, that some countries like Brazil or Uruguay have been much more successful than others. Yet advances in market and social incorporation in the future will face internal and external constraints. Two are particular important: (1) The role of China and its contribution to Latin America's specialization in the primary sector; (2) Limited state capacity in several countries.

China's steady growth has been one of the main drivers of growing demand for Latin America's primary goods in recent years. In 2009, for example, exports from Latin America to China grew by 5% at a time when all other exports decreased by 27%.

During the first half of 2010, Chinese imports from Bolivia and Uruguay increased by 129% and 102% respectively.

Unfortunately, the growing Chinese demand for primary goods is locking Latin America in a traditional specialization in natural resources. In 2008-09, exports of raw materials and primary-based manufactured amounted for 59% of all Latin American exports compared to 55% in 2005-06 and 44% in 2001-02. Four fifths of Chinese imports from Latin America are primary goods, while a majority of Chinese exports to the region are manufactured goods with increasing technological content. Chinese products like clothes, toys, furniture and electronics have flooded the region, and small and medium firms have faced increasing difficulties to survive. In 2008, 22% of Chinese imports of Latin America were basic manufacturing goods, 25% were manufacturing good with medium technology and 35% were high technology products.

This trend is particularly problematic when one considers recent research on the importance of structural change for long term growth and the expansion of formal employment (Rodrik 2011; McMillan and Rodrik 2011). The mining, oil and modern agriculture sectors are not particularly labor intensive and have historically been unable to absorb surplus labor from other sectors. Given growing deindustrialization in several Latin American countries, a slowdown in Chinese demand for commodities could lead lower economic growth, a new expansion of informal employment and a reduction in economic-wide productivity.

The size of the domestic market and the willingness of the government to promote structural change will influence each country's responses to the Chinese challenge. Brazil is in a better position than everywhere else to reduce Chinese imports and also build strategic alliance in sectors like automobiles, planes and even IT with Chinese companies. Chile could develop new comparative advantages in primary-based manufactures with high value added, but only if it is able to implement more coherent supporting policies. Uruguay depends on regional integration and may suffer from further deindustrialization without it. Finally Bolivia and Peru may maintain their China-induced specialization in primary resources.

Internally, state capacity may constitute a major constraint for market and social incorporation in some countries. Following Skocpol (1985), inasmuch as states have control over their territory, such capacities depend on securing funding and personnel. The former includes the recruitment and retaining of qualified and committed people. The latter involve the collection and deployment of resources established by laws and other norms—mainly direct and indirect taxes. Latin American countries have

traditionally faced problems to raise enough taxes (Aldunate and Martner 2006). The region has a smaller tax-GDP ratio than countries with similar levels of development (Sánchez-Ancochea 2009). In an analysis of income taxes, the World Bank (2004) concluded that “Latin American tax efforts tend to lie below the average even in relation to income levels, with the exception of Nicaragua and Uruguay (Brazil is also closed to the norm). This is particularly true with regard to personal income and property taxes collection, as well as social security contributions” (p. 250-252).

In recent years the region has experienced some advances in this area. According to Cornia (2010), the increase in the value added tax and, to a lesser extent, corporate and personal income taxes contributed to the growth of the regional tax-GDP ratio from 17% in 2000 to 20% in 2007—with particularly positive performance in Argentina, Bolivia and Brazil. Tax reforms were on the policy agenda in several countries including Chile, which expanded income taxes significantly during the mid-2000s. Nevertheless, much of the increase in public revenues has been the result of higher commodity prices and royalties and may not be sustainable in the long run. Taxes in Latin America are still low and not particularly progressive and tax loopholes are widespread and lead to inefficiencies (OECD/ECLAC2011).

Bureaucratic capacity will also influence Latin America’s ability to promote market and social incorporation in the future. A Weberian bureaucracy independent from interest groups constitutes a necessary condition for effective policy making (Evans 1995) but has been traditionally absent in Latin America. Bureaucratic shortcomings are particularly significant in Bolivia and Peru, but excessive politicization of the civil service and institutional dispersion in decision making constitutes problems in almost all countries. Advances in these areas in recent years have been minimal as Panizza (2011) shows for the Uruguayan case. Will market and social incorporation continue in the future? The answer to this question partly depends on international conditions—global economic growth and the level of commodity prices in particular—but also on the ability of South American countries to implement appropriate policies. As we discussed in this paper, so far the picture here is mixed. In general, policies towards social incorporation have advanced more rapidly than any real effort to promote structural change. Even in Brazil, where industrial policy has become increasingly ambitious, there is a strong accent on the promotion of natural resources such as oil. As a result, if commodity prices slow down significantly, Latin American countries may be unable to further expand formal employment.

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