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Responding to Globalization

Social Policy in Emerging Market Economies

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abstract The article addresses some of the major themes influencing the development and reform of social policy in emerging market economies. It is argued in the first section that growing concern with social policy is largely associated with the increasing openness of these economies – globalization – and the new systemic risks that domestic economies now face. We look at the broad reform trends that seem to be shaping the social policy agenda around the world, particularly privatization of social insurance, means-testing of benefits, and decentralization of provision. This raises the question of whether or not the provision of social insurance is moving toward some type of convergence. In the final section, the role of the international community in the social policy debate is examined, with a focus on the World Bank and International Monetary Fund (IMF).

keywords *globalization, social policy, welfare state*

Where there are revenues the demagogues should not be allowed after their manner to distribute the surplus; the poor are always receiving and always wanting more and more, for such help is like water poured into a leaky cask. Yet the true friend of the people should see that they be not too poor, for extreme poverty lowers the character of the democracy. Measures therefore should be taken which will give them lasting prosperity; and as this is equally the interest of all classes, the proceeds of the public revenues should be accumulated and distributed among its poor, if possible, in such quantities as may enable them to purchase a little farm, or, at any rate, make a beginning in trade or husbandry.

Aristotle, *Politics*, Book 5, Chapter 6

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Globalization and Social Policy

The process of economic opening, like all policy change, brings in its train new patterns of winners and losers. Since the 1980s, economists have observed a trend of growing income inequality around the world, and since this trend is contemporaneous with increasing openness to trade and investment the question has naturally been posed about whether a causal relationship may exist. Several theories explain the distributional effects of trade. According to the 'factor price equalization' theorem, two economies that adopt a policy of free trade will find (given certain strong assumptions) that the returns to the factors of production in each country will tend towards equalization at some intermediate point. Further effects of trade opening on income inequality are also associated with the transfer of skill-enhancing technology (SET), and indeed SET models have become predominant in the debate over openness and its distributive consequences (Robbins, 1996). In developing countries the production of intermediate goods for sale in advanced industrial countries often relies on technologies that reward the more highly skilled workers. Of course one of the traditionally lauded benefits of opening less developed economies to the world market has been the transfer to such economies of new and more efficient production technologies. The distributional downside is that these technologies favor certain – more skilled – groups of workers, leaving others by the wayside. As Donald Robbins (1996) has argued, technology transfers to the south are associated with increasing income inequality.

Jagdish Bhagwati has advanced a third hypothesis regarding the effects of trade on wages. His argument revolves around the following four elements: (1) greater internationalization of markets and the increased integration of world capital markets may have narrowed the margin of comparative advantage enjoyed by many, leading to greater volatility in comparative advantage; (2) this in turn leads to higher labor turnover between industries and, hence, to more frictional unemployment; (3) increased labor turnover flattens the growth profile of earnings; and (4) the outcome of the previous three elements could be an increasing wage differential if skilled workers have greater transferability of workplace acquired skills than do unskilled workers (Bhagwati, 1998: 278). Bhagwati adds that, given increasing capital mobility, it has become easier for employers to say that 'they will pack up and leave', putting further pressure on the wages of the unskilled who are also the least mobile of workers.

We thus have several alternative theoretical models for evaluating the impact of trade liberalization on factor prices and incomes. But what data do we have for testing these models? Unfortunately, most of the work to date on the relationship between openness and factor returns has been done primarily within the OECD (Organisation for Economic Co-operation and Development) context.[1] Similar tests of emerging market and transition economies are in short supply. As Ravi Kanbur (1998) points out, in the African case 'lack of data is a particular problem...' (p. 18). In Latin America, most of the research on income distribution has looked mainly at the effects of structural adjustment as opposed to trade liberalization per se. Kanbur, however, cites one study of seven countries in Latin America in which it is argued that 'trade liberalization has had a significant (negative) causal influence' on income distribution.

Why should the possibility or actuality of rising income inequality in emerging market economies be of policy concern? One answer is provided by the literature broadly associated with endogenous growth and endogenous fiscal policy. This literature argues that inequality may inhibit growth, by one of two paths. Along the first path, it is argued that in democratic polities inequality leads to demands by the 'median voter' for redistributive tax policies. Since redistribution is aimed at those who save and invest – namely the rich – such taxes will depress investment and with it economic growth. In a globalized economy, moreover, any serious effort to 'soak the rich' may also be expected to spur capital flight, thereby shrinking the pool of savings available for investment even further.[2]

The second pathway presents a very different view of the relationship between inequality and growth. It rejects the notion that median voters are successful in their redistributive efforts, and instead that they take to the streets to voice their discontent with the status quo. This social instability, in turn, dissuades investors from placing their funds in long-term projects and, to the contrary, also provokes capital flight. The net result is again less investment and less growth (Alesina and Perotti, 1994).

Complementary to these traditions is a theoretical line in political science that relates economic change, including openness, with the demand and supply of social safety nets and asset redistribution more generally (see Acemoglu and Robinson, 1999; Kapstein, 1999). Much of this work was inspired by David Cameron's observation of a strong correlation between economic openness and the expansion of the public sector. He wrote that 'the growth of social insurance and tax systems represent "built-in stabilizers" which allow policy makers to "smooth out" the peaks and valleys of business cycles'. In short, there is a 'strong positive association between the level, and the rate of increase, of "openness" and the expansion of the public economy' (Cameron, 1978: 1250).

Implicit in Cameron's remarks is the notion of the state as an 'insurance agency' which acts to pool the risks borne by citizens in the face of economic openness. In this model, terms-of-trade risk will not be provided by private insurers due to the problem of covariance. As Dani Rodrik (1999: 98) puts it, 'the European welfare state is the flip side of the open economy'.

But social insurance does more than simply provide insurance against economic risk; it also has a powerful political objective. Rodrik (1999) argues that social insurance

> cushions the blow of liberalization among those most severely affected, it helps maintain the legitimacy of these reforms, and it averts backlashes against the distributional and social consequences of integration into the world economy. . . . In the absence of such institutions, *openness is likely to foster domestic social conflicts that will prove damaging*. . . . (pp. 98–9; emphasis added)

Rodrik's view that social insurance permits a country to have its globalization cake and eat it too is problematic in light of the endogenous fiscal theory literature cited above. If governments are unable to 'soak the rich' then they will lack the tax base needed to pay for these safety nets. Indeed, as capital mobility increases it may become even harder for states to enforce redistributive tax schemes (to the extent that taxation really is redistributive in the first place).

This point has been made forcefully by the IMF's Michel Camdessus. Camdessus (1998) writes,

> Globalization will make it increasingly difficult for countries to have tax levels that are substantially above those of the countries with which they compete. This 'tax competition' is increasingly a reality that cannot be ignored by countries, a reality that will make it very difficult for countries to increase their tax burdens to the levels required by the anticipated expenditure trends in the next generation.

And Vito Tanzi (2000) of the IMF's Fiscal Affairs Division argues: 'If globalization reduces tax revenue and the governments' ability to have tax systems that are progressive and equitable, the governments will lose a major instrument for promoting social protection' (p. 7).

These remarks should make us cautious about the political and economic opportunities that are available to policymakers for extending the welfare state in emerging markets. Squeezed between the external forces of globalization on the one hand, and the internal threat of a 'coup' by the rich on the other, public officials are constrained in their ability to offer social safety nets. As we later argue, this suggests a strong role for the international community in providing the resources needed to establish the insurance programs that are demanded by the most vulnerable citizens in the face of systemic economic change.

It has sometimes been argued that globalization and rapid economic change mean that the focus of the welfare state must shift to one of individual responsibility; indeed, Tony Blair is among those who have adopted this general line. This shift, however, requires opening up domestic market institutions to *all* members of society, so that they can compete on the basis of equal opportunity: a model that basically views equality of opportunity as a substitute – in the eyes of the median voter – for equality of income.

It appears that the relationship between openness and equal opportunity may all too often be in the form of a vicious, as opposed to a virtuous, circle. For example, the Inter-American Development Bank (1999: 48) states that the 'low returns to basic education' in regions like Latin America

> may reflect the influence of globalization through a number of conduits. The incorporation of China and other less developed countries into world trade may have exerted adverse pressure on earning for workers with only a basic education. . . . And combined with macroeconomic policies, trade liberalization in Latin America seems to have fostered the adoption of technological change that has displaced labor demand.

Tragically, in Latin America (and other developing regions) it is precisely those 'workers with only a basic education' who have the least access to the advanced training that they so desperately need if they are to remain competitive in the global economy.

Overall, the literature on the effects of globalization on the provision of social insurance and the deepening of capital (including human capital) markets does not give us much reason for cheer. On the flip-side, however, we must recall that even among the OECD countries a wide if narrowing range of welfare states may be found, from Sweden on the one hand to the United States on the other. Even among the Scandinavian countries, with their strong 'welfarist' traditions, sharp differences in social provision emerge. These empirical experiences suggest that states have continued to provide generous social safety nets in the face of the alleged systemic pressures arising from globalization.

But here too, as in other economic policy arenas, we may ask whether the general trend in social insurance is heading towards a particular, 'neo-liberal' model. In the next section we argue that three pervasive trends are shaping social policy reforms in almost every country: privatization of insurance; means-testing of benefits; and decentralization of provision. These trends, largely driven by neo-liberal ideology and advanced by the World Bank and IMF, reflect the efforts of a transnational coalition to adapt the nation-state to the exigencies of a more open economy. In effect, the overall purpose of these developments is to make the welfare state leaner and more efficient in the face of increasing capital mobility and international trade.

Privatization and Means-testing: Why Is this the Trend?

When one observes the changes that have occurred over the last two decades in the role of the state and welfare policy in (what used to be called) the Second and the Third World, one is struck by the prevalence of policy prescriptions similar to the ones routinely made in the developed western countries: (1) privatization, most notably of the pension system; (2) means-testing of social assistance; and (3) decentralization of social policy to the regional level.

Why are these policy approaches seen as the right ones for both developed countries and emerging markets to follow? The changes in 'real' variables which have produced a shift toward these options in the west – the aging of the population; the large share of social transfers in GDP; the end of the Cold War; and rising real incomes at least among the top earners (prompting many to opt out of state-financed systems) can only in part account for the popularity of the same policies in the emerging market economies: first, because aging of the population is not yet an issue with which many of the Less Developed Countries (LDCs) have to deal, since they are in the midst of their demographic transition; secondly, because social transfers were never as important (as the share of GDP) as they were in the developed countries; and third, because in many parts of the world, rising real incomes were not the reality of the last two decades. Most of Africa now has real per capita incomes lower than 20 years ago; so do almost all of East European and Central Asian transition countries. In Latin America, most of the countries are, at best, recovering from the lost decade of the 1980s. Finally, even the end of the Cold War, which has certainly affected the social policies in the west – with the collapse of a competitor which prided itself particularly on social protection provided to its citizenry – could hardly be said to have influenced social policies in most African and Latin American countries. The end of the Cold War was, of course, of signal importance for the formerly Communist Eastern Europe and Central Asia. It was probably important for some other countries like South Korea but hardly anywhere else.[3]

THE ROLE OF IDEOLOGY

It seems that to explain the changes in the role of the state with respect to social policy we indeed have to go back to ideology, and to Keynes who, in the often quoted closing paragraph of *The General Theory* wrote:

> the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. . . .[T]he power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas. Not, indeed, immediately, but after a certain interval . . . soon or late, it is ideas, not vested interests, which are dangerous for good or evil. (1964: 383)

The initial onslaught against what was viewed as a bloated welfare state, and against some of the state's functions that many came to associate with post-Second World War developments in Western Europe and, albeit to a lesser degree, in the US (although we should remember Johnson's 'Great Society'), came with the Thatcherite reforms in Great Britain. The same wave washed over to the other side of the Atlantic during the Reagan Administration, and then proceeded to affect the rest of the world. The role of international financial institutions (IFIs) like the IMF, the World Bank, and Inter-American Development Bank, and of the small circle of economic advisers, reflected in the Washington consensus – viewed by some as a neo-liberal manifesto forged in the wake of the Latin American debt crisis – was considerable. However, it is interesting to note that the Washington Consensus as originally defined by John Williamson in 1990 all but left out social policy: there was only a short suggestion that public expenditures be redirected from defense, general subsidization and 'white elephants' to primary health care and primary education. In other words, the 'consensus' did not come out, at least explicitly, in favor of expenditure reduction but in favor of expenditure switching. When Williamson revisited 'his' consensus in 1997, he added targeted anti-poverty policies to the list of expenditures that need to be expanded (Williamson, 1997).

The IFIs do not work, of course, in the vacuum, but reflect the dominant ideological atmosphere, mostly, of the dominant members or member. One of the means whereby the 'gospel' of the minimalist state was spread by the international institutions was structural adjustment lending whose importance increased in the decade of the 1980s. This influenced economic policies first in the south, and, after the end of the Cold War, in the east.[4] The recommendations often followed the 'one size fits all' approach. This was particularly the case after the regime changes in Eastern Europe, in large part because the World Bank's and the IMF's knowledge of these economies was limited both in space (only Yugoslavia, Hungary and Poland were members) and in issues (since the entire work program on formerly socialist economies focused on macroeconomic issues and the 'productive' sectors).[5] The social sphere recommendations that followed in the early days of transition were often criticized for being out of touch with the reality and history of countries. For example, one of Hungary's most eminent social scientists, Zsuzsa Ferge, argued that the Bank was quite oblivious of central European history and culture which, in ethnically homogeneous societies like Hungary's, stresses the need for social solidarity. Some Central European countries were upset at being given the same recommendations as Kyrghyzstan and Uzbekistan. A Bulgarian economist writes:

> When I read what the IMF, the World Bank and other international financial institutions say about Bulgaria I always ask myself a question: is it the same country where I live and which I see with my own eyes of a citizen and a professional? The true Bulgaria is very, very different from the one presented by the IMF and to a lesser degree by the World Bank publications. And this is particularly true for the social dimensions of transformation. In this respect the treatment of Bulgaria by the IMF, the World Bank and the big western powers resembles very much the treatment by the leaders of the former Soviet Union. *Now, as in the past we learn of our 'great achievements' from the statements of foreigners, and particularly foreign dignitaries visiting us for a couple of hours and seeing only the President, the Prime minister and their entourages.* (emphasis added)[6]

In addition to the ideological changes and the role of IFIs that came, to the so-called Second and the Third Worlds, 'from without', at least one important influence came from within. Moreover that important example would, in turn, influence economists and policymakers in the developed west. We have in mind the example of Chile in the wake of General Pinochet's accession to power, even if the influence of his neo-liberal experiment would take several years to ripple through the international policy community. First, the two changes that we have identified in the title of this section, privatization and means-testing of welfare, have been implemented in Chile. Privatization of the pension system was a watershed, so much so that the very details of Chilean privatization techniques were later copied in other countries, or at least influenced their reforms (e.g. in Argentina, Kazakhstan, New Zealand, and in a milder version of so-called 'notational contributions' in Sweden, Italy, Latvia, Hungary and Croatia). Introduction of work fare and public works, which at their peak in 1982 employed 13 percent of the labor force, was another.[7] Finally, the effort put in improved targeting of social assistance with the creation of a poverty index, *Ficha*, which was later copied in a number of countries, including most recently in Armenia and parts of Russia.[8]

What was so unique about Chile? Chile combined three features that are seldom found together and whose combination made the Chilean experience, at least to the economists, an example to follow. First, Chile was, under Pinochet, a right-wing dictatorship. But, secondly, unlike many such dictatorships, this one was not solely concerned with the self-enrichment of its rulers. The rulers were willing to open almost the entire economic sphere to the economists, and not hem them in with the need to tailor their policies either to allow the rulers to amass wealth or to please the crowd. Economic policy could thus steer clear of both 'cleptocracy' and populism. Unlike economists advising democratic or populist governments, those in Chile were untrammeled by the political parties, trade unions, parliaments; their decision did not have to be debated in the political arena. Even if many might not (openly) agree, Chile was for some of the economists (and particularly for those of right-wing persuasion) the closest one comes, this side of Hades, to a benign dictatorship.

Finally, the third, and possibly the most unusual, feature for a right-wing dictatorship was that some of the country's neoclassical economists were interested in social issues. Miguel Kast and a number of economists from the ODEPLAN, the agency that was set up to define and implement the new welfare policy, launched an admittedly technocratic, but very important, program of social assistance. Targeting of welfare benefits, introduction of work fare, and school lunches were designed and followed by the agency's economists. The emphasis on targeting of welfare was not by itself new: it was a key feature of the residual welfare state (as in the United States and Switzerland), but the thoroughness with which it was applied was new for the Third World. No one who has seen the detailed poverty maps of Chile produced by ODEPLAN could have remained indifferent nor failed to be impressed with the seriousness and thoroughness with which 'the fight against poverty' (viewed almost as a disease to be eradicated) was undertaken.

What started in Chile in the mid-1970s became in many countries of the world an orthodox prescription some 15 or 20 years later.

THE ROLE OF GLOBALIZATION

If the example of Chile provided an 'internal' stimulus for social policy reform within emerging market economies, systemic factors in the form of increasing economic openness were also at play. There are, to simplify somewhat, two views on the effect of globalization on the role of the state in social policy. Both have some theoretical merit, though neither has enough empirical support to claim victory in the paradigmatic debate.

One prominent position, drawn largely from public finance theory, holds that globalization leads to what is called 'the race to the bottom' whereby countries with more developed (and costly) social protection systems are forced, due to international competition, to downscale their social transfers in order not to lose potential foreign investors (see Deacon, 1998a). Similarly, Benvenisti (1999) writes: 'Globalization provides ever-growing opportunities for small groups of producers, employers and service providers to shop the globe for more amenable jurisdictions. An international "race to the bottom," spawned by the decreasing exit costs of many businesses threatens to compromise the achievements of the welfare state.' Implicit in this view is the worldwide dominance of capital over labor. Capital is mobile, thus politically stronger. Governments want to attract capitalists to invest in their countries and are willing to trade workers' rights (and social protection in general) for the higher income that comes with greater investment. The trade-off between social security and income is, in this view, quite sharp: it is politically expedient to sacrifice a lot of security for a given increase in income. Faced with such behavior from other governments, each individual government has no choice but to implement the same 'capital-friendly' policies both to keep its own capital at home and to attract others. This is not much different from the mercantilists' view of trade, except that instead of exports and imports of goods we deal with exports and imports of capital. In both cases, economics is a zero-sum game: my country's gain in foreign investment capital is somebody else's loss.

A different, and one might say historically oriented view, holds that the maintenance of social cohesion is a sine qua non for globalization to proceed (see for example Kapstein, 1999: 31; Rodrik, 1998: 157). For without social cohesion, the electorate (median-voter) might easily succumb to the temptation of populists and demagogues who espouse protectionism and nationalistic policies directly opposed to international integration. In this view, for globalization to be safe it has to be based on the bedrock of social consent. To maintain social consent requires maintenance of the safety net structures built in the developed economies over the last half a century because they have ensured the preservation of the capitalist system – when it was threatened by the dual forces of the Great Depression and Communism (and also, briefly but powerfully, by Fascism) – and have led to its unprecedented expansion and the very globalization that we are witnessing today. Globalization and the expansion of social protection, in this view, far from being inimical are, on the contrary, complementary.

If we consider how globalization and the welfare state were related in the past, in order to possibly draw lessons for the present, a natural place to start is the period of globalization that lasted from the second half of the 19th century until 1914.[9] In the words of Karl Polanyi (1985), this is the period when 'nothing less than a self-regulating market on a world scale could ensure the functioning of [capitalism]. The expansion of the market system in the 19th century was synonymous with the simultaneous spreading of international free trade, competitive labor market, and gold standard: they belonged together' (pp. 138–9). This period coincided with the birth of the modern welfare state. The first, trend-setting social insurance was introduced in Bismarck's Germany (health, and accident insurance in 1883–4; and old-age insurance a few years later).[10] This was done in reaction to the growth of the socialist movement in Germany, and Bismarck's decision to ban the Social Democratic party in 1881 was followed by his insistence on the introduction of social insurance as a way to undercut that party's popular support by offering workers most of the measures advocated by socialists.

If we view, as we believe one should, the development of the socialist movement in the second part of the 19th century mainly as a response to the 'problem' of a globalized capitalism, it then becomes apparent that the extension of the welfare state was *caused* by globalization and the insecurities it engendered in the context of the international gold standard. The events of 120 years ago resonate with what we observe today, or rather with the dilemmas we face today. This historical analogy thus supports the position of those economists today who regard the preservation of the social acquis in the developed countries (and even their expansion) as needed to provide the cushion against which globalization can take place. Or, to answer the question we posed above, globalization rather than leading to the race to the bottom would require a strengthening of the social insurance functions.[11]

But how is this to be achieved in poorer, emerging market economies? This is where one might doubt that the analogy with the previous spur of globalization is a valid one. For there are arguments put forward that today's reality is different from the one more than 100 years ago: a new political coalition may be emerging. The coalition's interest may lie in the scaling down of the welfare state and it may be sufficiently strong politically to achieve this objective, as indeed the experience of the last 20 years seems to suggest.

A NEW TRANSNATIONAL COALITION?

It is a truism that for any policy to be implemented there must be a political constituency to support it. Several writers have noted the emergence of a new coalition in many less developed countries. The 'new coalition' differs significantly from the social coalitions typically found during the era of industrialization and import-substitution. Looking at the Turkish example as a prototype, Ziya Onis (1991) described the standard coalition of the 1950s and the 1960s as the 'national developmental coalition'. It was composed of state bureaucracy and big bourgeoisie, and supported by pliant trade unions, who in exchange for abandoning militancy, received government protection of their jobs. The coalition's objective was the introduction of capitalism tempered by a significant state involvement in the economy, in the form of regulations, protective tariffs, and public enterprises. The need for public involvement was classically explained by the small size of the domestic capitalist class, their low saving rate, and hence slow capital accumulation if development were to be left to them alone. In the famous words of Sergei Witte, the Russian Tsarist Minister of Finance, uttered in the 1890s, 'by what other means than artificial [state protection], can an industry be developed?'

However, discrediting of the import-substituting policies during the last two decades, the growing power of international capital, and rising importance of free market ideology have, in the words of Mine Aysen (1999), brought about a new 'neo-liberal transnational coalition' composed of foreign investors, liberal segments of the business, and technocrats at the governmental level. A similar view is put forward by Benvenisti (1999) and Sklair (1997). Benvenisti argues that instead of viewing states as homogeneous entities (the Westphalian paradigm), the

> alternative view suggests that many domestic interest groups cooperate with foreign interest groups located across national boundaries in order to impose their externalities on their respective rival domestic groups. . . . [The] current norms and procedures, both constitutional and international, are inherently slanted in favor of groups with historically stronger voice in domestic political arenas, and provide them exit options from domestic regulation. These exit options permit the global race to the bottom and other collective action failures.

Now, the interests of the new coalition are at best indifferent to the welfare state, and most likely to view it as a burden upon the countries' competitiveness. For the proponents of this view, social cohesion as such may not have much meaning:[12] they would argue that a better way to promote it is through increasing people's incomes rather than through an extension of the role of the state. And people's incomes are, in turn, most efficiently increased by the pursuit of liberal and capital friendly policies. Thus, the new coalition, even if it does not discount the importance of social cohesion as a desirable objective, views the tools to achieve it to be entirely different from the ones advocated by the old 'national developmental coalition', and consequently its favorite economic policy mix is quite different.

CONVERGENCE OF WELFARE STATES ON THE ONE HAND, AND DIVERGENCE ON ANOTHER?

Implicit in the 'race to the bottom' hypothesis is a view that most economies will end up by having the same, fairly stripped-down, system of social protection. Equally or more likely may be a following three-pronged scenario: (1) convergence toward the 'middle' amongst the OECD welfare states; (2) their mutual 'rapprochement' with the currently very lean East Asian model as the welfare state in the latter group expands; and (3) further falling behind, in terms of social protection, of the less successful East European reformers, and the poorer LDCs, where the welfare state will remain practically non-existent. We could thus end up with two clubs: the rich, with a welfare state which is neither as extensive as it is currently in Scandinavia, nor as niggardly as it is in East Asia, but is somewhere between; and the poor club with practically no social protection except for the few people employed by the government.

Several empirical facts seem to point toward such a development.[13] First, the differences between the various western models of capitalism seem to be diminishing. In the late 1980s when Esping-Andersen published his famous *The Three Worlds of Welfare Capitalism*, the differences between the universalist (Scandinavian), corporatist (continental European), and residual or liberal (Anglo-Saxon) worlds of welfare capitalism were relatively sharp. The last decade and a half have witnessed the erosion of some welfare state functions in the Scandinavian countries (introduction of private pensions in Sweden, and reform of the state pension system in 1998, reform of sickness and unemployment benefits in 1993),[14] and changes in the corporatist systems (pension reforms in Germany and Italy, sick pay reform in Germany) diluting the corporatist origins of these systems. In a very detailed study of the evolution of European pension systems after the Second World War, Johnson (1999) documents this growing convergence.

The more nuanced view on the convergence is that of Scharpf (1997, 2000) who discusses the adjustment of 12 advanced welfare states to the international economic environment from the early 1970s to the late 1990s. He argues that the adjustment, and possible albeit weak convergence, was driven by political factors, many of them imposed by the EU membership, and not by the international changes. In Scharpf's view, Esping-Andersen's classification still represents a useful theoretical construct. It is the countries that follow the corporatist (European continental) model that have the most difficult time with the adjustment because they combine high taxation (which hinders their international competitiveness), and use taxes to pay for cash transfers instead of stimulating public employment (the way Scandinavian countries do), which, in turn, renders their overall employment rates low.

The role of the European Union in stimulating the convergence is large, both because a single economic space imposes the same requirements on member countries, and because it ensures a better diffusion of information. The importance of differences in historical developments, which shaped the formation of different welfare cultures in early 20th century Europe (e.g. the role of the Catholic church; the more or less exalted position of civil servants; the differences in the role of trade unions; differences in the strength of Socialist and Communist movements), has much diminished now. Consider a few examples. The Communist movement, which was strong first in Germany, then in Spain, France and Italy (but never in northern Europe), is now practically non-existent in these countries (of course, former Communists are in the government in Italy, but they are neither carriers of, nor believers in, an alternative ideology). The population growth rates which differed between Catholic and Protestant countries have gone down in both, and moreover are now lower in Catholic Italy or Spain than in Protestant Scandinavia. The secular role of the Catholic Church has declined with decreasing numbers of regular church-goers: one needs simply to contrast the role that the Church played in the early 20th century in, say, Spain, Portugal or Hungary, with today. Even Poland, where the importance of the Church peaked during the Communist period, is now reverting towards the European mean.

Secondly, while the erosion of OECD welfare state (see Boltho, 1997) occurred in the west, East Asian countries – following upon dramatic real income increases there – have introduced new social programs, for example unemployment insurance in South Korea and Taiwan in 1998 and 1999. Thus, the distance between their welfare states and the one in the west has diminished.

Tables 1 and 2 give a schematic representation of what seems to have been the developments over the last 20 years (the shaded cells represent changes). The introduction of unemployment insurance in South Korea and Taiwan, its consideration in Malaysia, reflect a movement toward a more extensive welfare state in Asia. The slippage of social protection in the less successful among the former Communist countries is an indicator of these countries' convergence toward the Third World. Thus, while the more developed among Asian countries seem to be moving closer to the OECD-type of welfare state, a part of the former Communist Second World is slipping to the Third World status. We witness both a weak convergence (among the richer countries), and polarization of the welfare state at the world level – splitting the rich countries from the poor.

table i *Welfare state around 1980*

	Communist countries	*Western OECD countries*	*East Asia*	*LDCs*
Universal or near universal pension provision	Yes; high replacement rates in Eastern Europe, low in the USSR	Yes; high replacement rates	For civil servants only	For civil servants only
Universal or near universal provision of family benefits	Yes in Eastern Europe; not in the FSU	Yes except in the US	No	No
Unemployment insurance	Full employment	Yes	No	No
Socialized health	Yes	Yes except in the US	Limited	No (in practice)
Socialized education	Yes	Yes	Yes	Yes (limited)
Score	5	5	2	1 1/2

The Role of the International Community

So what is to be done for those emerging market economies that seek to provide a modicum of social insurance in the context of a globalizing economy? As we have argued, pressures on these states come from within and without. From within, it is unlikely that those who hold wealth will welcome the redistribution that the welfare state must bring. From without, it is unlikely that the global economy will support high levels of social protection in emerging markets. As a result, we would argue that foreign assistance can and should play a critical role in promoting investment in social policy development in these economies, and that this investment must be targeted at the 'losers' from economic and technological change – those who are least advantaged. Indeed, these programs should be part and parcel of international economic policies designed to promote greater opening.

Meeting that challenge will require both an increase in aid funding and a redirection of allocated amounts. While we recognize the immense political challenges that face both these developments, we believe that a strong case for this strategy can be made. After all, to the extent that the advanced industrial states are truly committed to promoting democratization around the world, for reasons of both economic self-interest and national security, this investment should be seen as both moderate and prudent.

Clearly, the spending trend for foreign assistance at present is not promising. Official development assistance (ODA) by the major industrial table 2 *Welfare state around 2000*

	Former Communist countries		*Western OECD*		
	Central Europe	*Others*	*countries*	*East Asia*	*LDCs*
Universal or near universal pension provision	Yes	Very low replacement rates	Yes; high replacement rates	For civil servants only	For civil servants only
Universal or near universal provision of family benefits	Yes	Limited	Yes except in the US	No	No
Unemployment insurance	Yes	No	Yes	Limited	No
Socialized health	Yes	No	Yes except in the US	Limited	No (in practice)
Socialized education	Yes	Limited	Yes	Yes	Yes (limited)
Score	5	2	5	2 1/2	1 1/2

Note: Family benefits and unemployment insurance in non-Central European, formerly Communist countries do not differ formally from those in Central Europe. However, their puny amounts, limited coverage, and large arrears make these rights practically irrelevant. For these reasons, Kazakhstan has recently formally abolished unemployment benefits. The same is true for a formally socialized health care, when receiving even a modicum of 'free' health care requires that patients bring in their own drugs and food and pay bribes to the doctors.
Score calculated by giving 1 point for each 'yes' and half a point for 'limited'.

countries reached its postwar high of US$70bn in 1991. Since that time, it has tumbled to insignificant proportions, largely because of decreased spending by the United States; while the US economy constitutes 30 percent of the industrial world total, its aid contributions represent less than 17 percent of all official flows traveling between 'north' and 'south'. As a result, the member-states gathered in the Development Assistance Committee (1998) of the OECD recently judged 'the current level of American aid as inadequate . . .' (p. 1).

Overall, the advanced industrial democracies now allocate less than 0.25 percent of their Gross National Product (GNP) on foreign assistance, or 50 percent less than they provided at the outset of the 1990s. It is hard to think of any other program, domestic or international, that has suffered such reductions. The end of the Cold War, on the one hand, and renewed fiscal pressure on the welfare state, on the other, have basically doomed aid budgets everywhere.

At the same time, perceptions about the utility and effectiveness of aid spending will need to be changed before there is any significant shift in public support. The polling data taken by the aid organizations themselves reveal widespread skepticism about the efficacy of aid programs; the belief that such funds 'go down a rat hole' is widely held by the public. With that in mind, a major step in the right direction by the aid community is provided by the World Bank's recent report, *Assessing Aid*. That report is brutally honest about the errors that have been made in the past, and circumspect about future promises. Nonetheless, the report provides clear evidence that it is possible to target aid and make it more effective in supporting the goal of greater opportunity, especially for the least advantaged.

Specifically, the World Bank (1998: 2–4) has found the following with respect to program effectiveness. First, foreign aid succeeds when it compliments domestically sound economic policies. That is, it can help promote overall growth and the expansion of individual opportunities in those countries that pursue macroeconomic stabilization and structural adjustment measures. It should be emphasized that the effect of such assistance 'is large . . . 1 percent of GDP in assistance translates into a 1 percent decline in poverty and a similar decline in infant mortality'.

Secondly, in such reform-oriented settings, aid and private investment are mutually supportive; contrary to commonly held beliefs, there is no evidence that aid 'crowds out' the private sector. There are several reasons for this positive relationship between aid and investment. For foreigners, the presence of official development assistance often provides 'comfort' that donor nations are engaged with governments in the reform process, and will put pressure on any government that seeks to extort funds from private investors or to nationalize their holdings. For domestic investors, aid that supports infrastructure and institutional development makes the local setting more attractive and promising over the long haul.

Third, aid in the form of technical assistance can increase the capacity and capability of state actors. Not only can it be used to help countries import effective policies in such areas as health care, education and environmental management, but by providing advice about how to make more efficient use of inputs it can also expand the range of outputs. As a result, higher quality public services end up reaching more and more citizens.

What these points suggest is that, going forward, aid must be better targeted both with respect to recipients and feasible projects. Aid should be targeted not only at those countries that are committed to economic reform, but more specifically at governments that are also committed to expanding education and work opportunities for the least advantaged. All too often, as the World Bank (1998) admits, educational expenditure in developing countries has 'not always reached groups that have traditionally had low levels of education (the poor and girls, for instance)' (p. 108).

One strategy the Bank advocates in this respect is further decentralization of educational expenditure. Indeed, this is associated with the broad movement toward fiscal decentralization around the world. This strikes us as a promising development only to the extent that the case can be made that local governments have the administrative capacity required to carry out such programs, and are more responsive to the needy than are central governments. The jury on that particular question is still out, and in particular we are concerned by the possibility of corruption that might be associated with greater programmatic decentralization.

Still, the evidence to date bears careful examination. According to a study of three World Bank programs of decentralized educational expenditure in El Salvador, Pakistan and Brazil, the results have been impressive. 'In each case decentralizing and involving civil society led to improvements in public services – specifically the broader availability of schooling to disadvantaged groups' (World Bank, 1998: 111). Whether these gains are 'one-shot' or sustained remains to be seen; and in this respect we would emphasize that, while giving 'civil society' a greater voice in policymaking is certainly consistent with democratization as we define it, some non-governmental organizations that pose as representatives for women, the poor, or other groups are often less transparent than governments themselves.

More broadly, our discussion leads to the conclusion that the World Bank, International Monetary Fund, World Trade Organization and major bilateral donors ought to re-examine their economic programs and policies in light of the connections we have drawn between openness, growth, and social insurance. The received wisdom provides an optimistic view about the evolution of the political economy, teaching that open markets promote efficiency, which produces growth and, ultimately, the wealth needed to 'buy' social insurance. But that outcome, we have sought to demonstrate, is critically mediated by domestic political institutions which may capture the gains from trade for an elite, denying the majority of citizens either safety nets or the equity of opportunity that would enable them to become 'winners' themselves. Indeed, in all too many countries, a 'vicious' as opposed to a 'virtuous' circle of economic development has been established. Breaking that circle, and transforming the former into the latter, will certainly require the good work of courageous leaders within domestic societies, but without foreign assistance their best hopes for the democratic future are unlikely to be realized.

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notes

1. For a review of the recent literature, see Ethan B. Kapstein (2000).

2. Two of the key articles in this tradition are Persson and Tabellini (1994) and Alesina and Rodrik (1994).
3. Jaehyun Joo (1999) reminds us that both the introduction of medical insurance for workers and the minimum wage in respectively 1976 and 1986 was done in response to political pressure – one in order to counter the North Korean propaganda about the superior status of the workers in the North (which was even reflected in the official ILO documents), another in order to undercut the more radical wing among the trade unionists opposed to the military regime.
4. On the role of IFIs in transition economies, see Deacon et al. (1997).
5. In the United States, of course, the intelligence community devoted considerable attention to the Warsaw Pact's defense economy and defense industries.
6. Mr Ivan Angelov in a personal communication to Branko Milanovic.
7. See Carol Graham (1991: 13).
8. *Ficha* used a variety of characteristics (but not income) to which different weights were assigned in order to come up with a cardinal measure of eligibility for various social assistance programs (complementary feeding, preschool care, school lunch program, health care).
9. This is, of course, the same approach as used when trying to assess the effect of globalization on a number of other economic indicators (international trade, foreign direct investment, migration etc.). Several recent papers (Baldwin and Martin, 1999; Williamson, 1996) do this, but none has looked at the relationship between the 1870–1914 globalization and welfare state.
10. In terms of redistributive old-age pensions (that is, pensions which in addition to employer and employee contribution would include the one directly paid by the state) Germany was preceded by Denmark (see Lindert, 1992: 11). The Danish example, however, did not have nearly as much influence as the German. It is also interesting that Bismarck strongly argued for state participation in the funding, but that the proposal was twice turned down by the Reichstag (see Taylor, 1955).
11. For example, Rieger (1998, cited in Deacon, 1998b) supports the case that trade in the United States, openness, and expansion of welfare spending have gone hand in hand (although one needs to be mindful of the possibility that both are driven by other variables in which case the causality between the two may be spurious).
12. In Mrs Thatcher's words 'There is no such thing as society. There are individuals and there are families' (Fanning, 1999: 546). Mrs Thatcher, of course, illustrated Keynes' aforementioned quotation regarding the role of ideas. The same view, albeit more subtly, was propounded by von Hayek (1973–6) in his *Law, Legislation and Liberty*.
13. The same view is taken by Barr (2000: 22–4), in a paper prepared for this conference, and by Atinc and Walton (1998: 25). They single out forces of urbanization, growing importance of formal employment, and aging, which all push East Asian countries toward higher social spending. Barr adds to this the fact that social transfers have historically been a superior good, and notes weakening family ties in many Asian countries.
14. The unemployment benefit replacement rate was reduced from 90 to 80 percent with the first five days of unemployment uncovered; the sickness benefit replacement rate was reduced from 80–90 percent to 65–80 percent; retirement age was raised from 65 to 66 years.

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résumé

Réponse à la Mondialisation: Politique Sociale dans les Économies de Marché Émergentes

Cet article présente quelques-uns des thèmes majeurs qui influencent la mise au point et la réforme de la politique sociale dans les économies de marché émergentes. Dans la première partie, nous défendons la thèse selon laquelle les préoccupations croissantes liées à la politique sociale sont dans une large mesure associées à l'ouverture croissante de ces économies – la mondialisation – et aux risques systémiques auxquels ces économies intérieures se trouvent désormais exposées. Nous examinons les grandes tendances en matière de réforme qui semblent façonner les programmes de politique sociale partout dans le monde, en particulier la privatisation de l'assurance sociale, la vérification des ressources pour les prestations, et la décentralisation du financement. Ceci soulève la question de savoir si le financement de l'assurance sociale est en train d'aboutir ou non à une sorte de convergence. Dans la dernière partie, nous examinons le rôle de la communauté internationale dans le débat sur la politique sociale, en nous concentrant sur la Banque Mondiale et sur le Fonds Monétaire International.

resumen

Respuesta a la Globalizacion: Politicas Sociales en las Economias de Mercado Emergentes

Este artículo trata algunos de los principales temas que influyen sobre el desarrollo y la reforma de las políticas sociales en las economías de mercado emergentes. En la primera sección sostenemos que la creciente preocupación respecto de las políticas sociales está principalmente relacionada con la creciente apertura de dichas economías – o globalización – y con los riesgos sistémicos que actualmente enfrentan las economías nacionales. Examinamos las tendencias generales de reforma que parecen estar dando forma a la agenda de políticas sociales a nivel mundial, en particular la *privatización* de la seguridad social, la *prueba de insuficiencia de medios* como condición para obtener beneficios sociales, y la *descentralización* de la provisión de servicios sociales. A su vez, ello suscita la cuestión de si la seguridad social está encaminándose a una cierta convergencia. En la última sección, examinamos el papel de la comunidad internacional en el debate sobre políticas sociales, con especial atención al Banco Mundial y el Fondo Monetario Internacional.

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