Towards an integrated *vision for dealing* with instability and risk

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This article puts forth a hypothesis and a challenge. The hypothesis: structural change in the international economy and in the management of public policy has brought about changes in economic performance, affected employment, poverty, and equity and resulted in greater insecurity and uncertainty. The challenge: coping with this insecurity and uncertainty despite public policy's abandonment of its historical role and the lack of success thus far of the new approaches. This study points to the greater vulnerability today stemming from the labour market as well as asymmetries in trends in poverty and equity and examines how to address the inevitable social consequences of instability. It also proposes how to go about managing the instability that comes from the international sphere; adjusting macroeconomic policy to lessen the effects of the cycle; reconciling the need for labour flexibility with the protection required to cope with greater vulnerability; protecting those who are most vulnerable; and moving towards universal social security coverage.

I

Introduction

The purpose of this article is to analyse the linkages between macroeconomic policies, poverty and equity. I intend to describe the context in which these linkages are now emerging and to identify the policies that may prove most useful as well as to lay out what is known about the appropriateness of direct policies aimed at dealing with employment and poverty issues. In particular, I will examine the effects of the greater risk stemming from operating in a more open and interconnected international economy and how that situation is being addressed so as to avoid the negative effects that it may have for the most vulnerable groups.

This is an initial overview that may lead to subsequent research, both of concepts and of specific country situations.

My basic assumption is that for two decades Latin America, like other developing regions, has been affected by a worldwide paradigm shift involving a structural transformation in the international economy and in the management of economic policy. This structural transformation has also stemmed from the ideological change brought about by the collapse of real socialisms and from the pre-existing diversity of approaches.

This mutation has entailed a different type of economic functioning and social consequences characterized by greater insecurity, and its main manifestation has been in employment, as well as in levels of poverty and equity. Today Latin America is a less secure region socially and economically; this introduces greater uncertainty and generates tension that affects individuals, families and society as a whole.

This article first addresses the structural context and its characteristics. Second, it addresses prevailing macroeconomic policy and its linkages with the international context. Third, it identifies new developments in employment, poverty and equity. Subsequently, it explores policies in five dimensions. The first, very briefly, addresses ways to diminish the effects of the instability generated in the international economy. The second concerns how to prevent risk and thereby reduce its impact at the macroeconomic level. The third regards labour and employment policies that would allow risk to be addressed, thereby preventing, insuring against or compensating for its effects. The fourth is related to social policies. The fifth addresses some of the effects on social cohesion. Finally, I will suggest some components of an agenda for dealing with risk and instability that should be researched in greater depth.

II

The structural setting

This section describes international and national structural changes, and, in particular, identifies three processes: globalization, privatization and liberalization (Tokman, 2001). These processes have resulted in a different global economy and have laid down new rules of operation for national policies, in addition to, in fact, limiting available options. There is less autonomy for designing policies at the national level and options have become more restricted.

This new form of operating is characterized, in addition, by greater instability and its more rapid transmission. A more integrated global economy, with a greater importance for financial issues in a context of rapid change in information technology, is making instantaneous the transmission process of both benefits and costs.

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The macroeconomic regime under which countries operate is changing. Employment is more closely linked with external demand, and the ability to expand domestic demand or raise wages above productivity gains is limited, either by the need to finance them or by the impossibility of transferring them to prices without affecting competitiveness.

Available empirical evidence analysed by the World Bank (De Ferranti, Perry and others, 2000) shows that in Latin America long-term instability, as gauged by the volatility of gross domestic product, is twice that of industrialized countries and higher than that of the countries of South-Eeast Asia. And instability in consumption is three times that of developed countries and is surpassed only by the countries of sub-Saharan Africa.

Moreover, unlike in industrialized countries, consumption volatility surpasses output volatility, which may be attributable to the lesser capacity to attenuate the effects of the cycle because of the existence of fewer assets, more limited possibilities of indebtedness and the less effective use of countercyclical policies.

It has also been found that the highest volatility was seen in the 1980s, whereas volatility in the 1990s was even lower than in the 1970s. This has led to the interpretation that increased instability and insecurity stemming from volatility was a short-lived episode— which does not preclude the need to introduce policies to reduce these phenomena. Nevertheless, a different reading of the same information allows us to arrive at distinct conclusions. First, the evolution of the 1990s does not include the effect of the Asian crisis after 1998. According to ECLAC (2000a), Latin America's average growth rate decreased from 3.8% from 1991 to 1997 to 1% from 1998 to 1999, and the variation coefficient increased by 50%, if we consider the entire decade, including the effects of the crisis. Second, although volatility was lower in the 1990s than in the 1980s and slightly lower than in the 1970s, we should qualify the previous statement by noting that in Latin America volatility evolved differently than in the industrialized countries. The differential in GDP volatility increased by a factor of 2.5 in the 1980s and decreased by a factor of 1.7 in the 1990s, although still remaining above the level seen in the 1970s. Differences in consumption increased, and were 3.3 times higher than in industrialized countries, in comparison with a factor of 2.4 and 3.1 in the 1970s and 1980s, respectively. Instability was high and was not clearly decreasing, which generated insecurity, insofar as it was transmitted through the labour market to employment, income and wages. I will return to these effects below.

In addition, we should stress three issues stemming from the processes of change in the aforementioned economic context. Globalization puts a premium on the search for international competitiveness and favours the adoption of defensive strategies for competing —through the reduction of costs, particularly labour costs, and greater flexibility in work processes— in markets with fluctuating demand. Privatization places a greater responsability for job creation on the private sector. This, in turn, requires closer linkages between economic and social policies, since —although economic incentives and stability are requirements for investment and growth— social legitimation and a perception of fair treatment are necessary for the sustainability of policies and the stability of the rules of the game. Liberalization means assigning greater importance to the role of markets as resource allocators and favours reduced government intervention. Although this may result in greater economic efficiency, it often leads to deregulation and a lack of protection, accompanied by greater social inequality.

III

Macroeconomic policy

The new macroeconomic regime and the policies guided by the different versions of the Washington Consensus tend to magnify vulnerability and to aggravate the instability and insecurity created by the transfer of real and financial volatility. Moreover, these policies tend to be procyclical, thus exacerbating instability, and fail to play the role of stabilizers.

As is noted by ECLAC (2000b), Keynesian stability, which combined internal equilibrium (stable growth, low inflation and near full employment) with external

equilibrium (sustainability of the balance of payments), has given way to a focus on external macroeconomic equilibrium and inflation and, moreover, to the association of stability with low fiscal deficits and stable exchange rates. Nevertheless, these variables are not necessarily indicative of more stable growth or full employment.

This approach was introduced to Latin America in the 1980s and guided the process of economic reforms adopted to address the debt crisis. It stressed trade liberalization, privatization and deregulation, and the elements of this approach were known as the Washington Consensus, because they constituted the prescriptions favoured by the Bretton Woods financial institutions, based in Washington, D.C. The original version of the Consensus sought, above all, to re-establish macroeconomic equilibria through fiscal discipline; the rechannelling of government expenditure; tax reform; trade and financial liberalization; competitive, unified exchange rates; an opening to foreign investment; privatization; deregulation; and security of property rights.

It was not until the 1990s that, because of the unsatisfactory results, the Consensus was expanded to include a second generation of reforms that emphasized governance and sought to strengthen the State's capacity. Hence, the original list was expanded to include legal and political reforms, regulatory institutions, anti-corruption efforts, labour-market flexibility, financial rules and codes, the "prudent" opening of the capital account, social safety nets and poverty reduction (Rodrik, 2001; Williamson, 1998).

The set of policies included in the different versions of the Consensus has tended to worsen real macroeconomic instability. Moreover, it has generally accentuated the business cycle and acted procyclically. This has been expressed in fiscal as well as monetary and credit policies, and in financial and exchange-rate policies. Tax receipts and fiscal spending evolve hand-in-hand with the cycle insofar as they expand when growth picks up and contract during recessions. The same occurs with monetary and credit policy, as the greater inflow of foreign capital during the growth phase allows private spending to increase and lowers the cost of credit; further, in the absence of prudent management, financial agents tend to increase the risk of their investments and to inflate the prices of the assets that back their loans. Financial "bubbles" often burst when, in the cyclical downturn, foreign capital changes direction, precipitating an inordinately deep contraction.

Instability, magnified by procyclical policies, entails costs resulting from greater uncertainty and leads to the underutilization of capacity together with microeconomic behaviour that discourages productive investment. This, in turn, exacts social costs of unemployment, poverty and income distribution because of the asymmetrical behaviour of the cycle: indicators contract quickly during a recession and are slow to react during the recovery.

IV
New developments

I will examine three areas where there have been new developments, stemming from the prevailing environment of instability: employment, poverty and income distribution.

It is through these mechanisms that volatility tends to spread, turning into economic insecurity and generating uncertainty among the population. In employment, three phenomena stand out: i) greater vulnerability to unemployment, ii) greater instability stemming from privatization, and iii) a change in the employment structure, which increases uncertainty because of the shift from formal to informal work, privatization and the loss of job security. Lastly, we must also analyse the volatility and evolution of wages.

Greater vulnerability to unemployment results in more rapid variations in unemployment in response to fluctuations in the pace of economic activity, facilitated by labour reforms that have expanded the grounds for dismissing workers and reduced companies' adjustment times. Similarly, greater volatility has been accompanied by asymmetries that suggest a faster adjustment to contraction than to recovery, which in situations of recurrent short-term crises has meant rising unemployment rates that are stable at the higher level.

The average unemployment rate for the region has climbed steadily, rising —according to World Bank data— from 6.6% in the 1970s to 7.6% in the 1980s and 7.9% in the 1990s, without taking into account the effect of the crises of 1998-1999. Similarly, International Labour Organization (ILO) data show the same trend, with average rates rising from around 4% between 1950 and 1970 to approximately 7% during the 1980s and 1990s (Tokman and García, 1981; ILO, 2002).

This trend can be observed more clearly in figure 1, which includes unemployment and GDP growth rates between 1980 and 2002. In the 1980s, the debt crisis caused unemployment to rise from 1983 to 1985, reaching an average rate of 8.4%. Thereafter, there was a gradual reduction until 1992, by when it had declined to between 5% and 6%. Subsequently, the unemployment rate once again began to rise, despite high GDP growth, and was stoked by three outbreaks of crisis in the 1990s: the "tequila" effect in 1995, the "Asian crisis" in 1998-1999, and the current crisis, in 2001 and 2002. Although the economic downturn brought about by the 1980s debt crisis was much more severe than that of any of the crises of the 1990s, unemployment rose much more quickly in the 1990s and tended to stabilize at higher levels following the crises, increasing from 7.9% to 8.9%, and then to the current rate of 9.3%.

The greater vulnerability to unemployment is partly related to the success in stabilizing prices, since low inflation rates in the 1990s made real wages more downwardly inflexible and shifted the burden of adjustment to employment. In addition, this was encouraged by the change in regulations governing dismissals and the introduction of more flexible labour contracts. Similarly, labour turnover is higher than in the countries of the Organisation for Economic Co-operation and Development (OECD), where 24.5% of all job holders have less than two years' seniority, compared with 38.1% in Latin America. The same is true of average job retention, which in the OECD is 10.5 years, in contrast with 7.6 years in Latin America. The higher unemployment propensity transfers instability to workers and their families and contributes to uncertainty not only among those who are directly affected but, according to available surveys, among a larger group, because of the fear the employed have of losing their job.

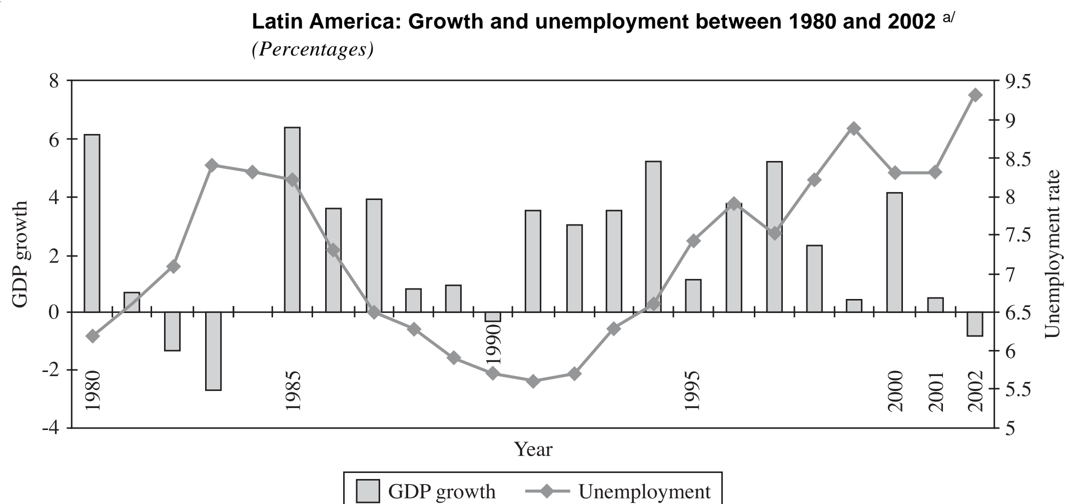
The second factor that contributes to greater instability is privatization. The transfer of job creation from the public to the private sector entails a change in the type of jobs. The protected, stable public-sector positions have been replaced with less permanent and protected positions. This does not necessarily mean lower wages, but it does imply a need to adapt to higher turnover in the labour market.

The public sector's share of non-farm employment contracted from 15.5% to 13.4% between 1990 and 2001. From a longer-term perspective, this indicates that the public sector did not contribute to net job

FIGURE 1

Latin America: Growth and unemployment between 1980 and 2002 [a]

(Percentages)



Source: ILO, 2002.

[a] Weighted averages.

creation in the 1990s, whereas in the 1980s it created 15 of every 100 new jobs. Part of the reduction in government employment translated into higher unemployment and the rest into private-sector employment. Some persons found work in modern sectors, but most moved into informal activities in microenterprises or into own-account employment. Government jobs have been —and in most countries continue to be— characterized by a statutory regime with contractual job security and full social protection, which tends to partly compensate for wages lower than those in the private sector. The transfer towards the private sector and the State's smaller role as an employer, which has differential effects on older groups, in the first case, and on younger groups, in the second, means a loss of protection for those who find work. Net income will not necessarily be lower, but income and employment volatility will be higher. Hence, instability and uncertainty increase.

The third phenomenon affects the structure of employment and is the result of the shift from formal to informal work, the shift of employment from goods-producing sectors to services, and the loss of protection. This increased share of employment in the informal sector means that a significant and growing proportion of new jobs are created in this sector. Between 1990 and 2001, two of every three jobs were generated in the informal sector, whose share of non-farm employment increased from 42.8% to 46.3% in that period. Forty-seven of every 100 new informal positions were non-professional, own-account employment or corresponded to unpaid family work; 34 were created by microenterprises; and the rest (19) corresponded to domestic service.

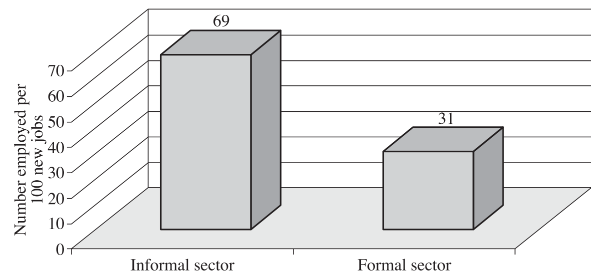
Employment in the services sector also grew. The proportion of job holders in services grew from 71.2% to 74.6% of non-farm employees between 1990 and 2001. Ninety-six of every 100 new jobs during this period were generated in the services sector. More than half (54%) of the new jobs were created in community and personal services, 25.4% in commerce and 6.6% in transportation. Lastly, the third process was the loss of protection, as the share of workers without contracts or with temporary contracts that did not include access to labour and social protection increased. Forty-three of every 100 new jobs created did not offer access to social security services.

These three processes are not independent. On the contrary: they overlap, since informal employment is concentrated in services and results in a lack of protection. Services, in turn, are concentrated in low-productivity activities because services associated with globalization and modernization, although increasingly important, are still not significant. The lack of protection overlaps with the first two processes. Together, they produce greater instability and uncertainty by increasing

FIGURE 2

Latin America: Job creation by occupational stratum, 1990-2001

(Percentages)

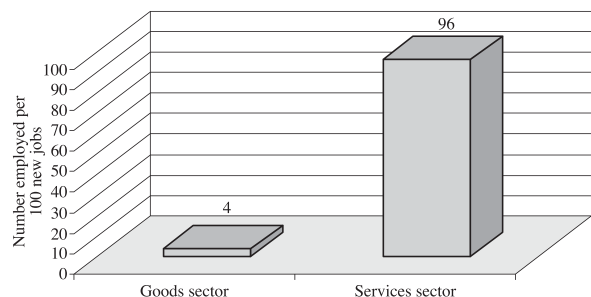


Source: ILO, 2002.

FIGURE 3

Latin America: Job creation by branch of economic activity, 1990-2001

(Percentages)

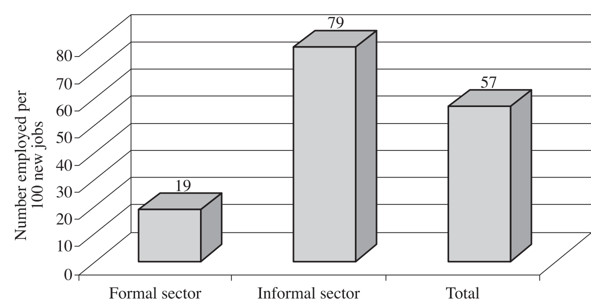


Source: ILO, 2002.

FIGURE 4

Latin America: Creation of wage-earning jobs paying social security contributions, 1990-2001

(Percentages)



Source: ILO, 2002.

the relative importance of jobs of shorter duration and with less labour and social protection.

Lastly, we will consider wage volatility to determine if it contributed to increasing uncertainty. An examination of the evolution of real wages over the last three decades shows that average volatility in Latin America in the 1980s was twice that of the 1970s. Nevertheless, in the 1990s wage volatility returned to levels similar to those of the 1970s (De Ferranti, Perry and others, 2000). To a large degree this is explained by the significant, widespread reduction of inflation rates from 1990 to 1999. In particular, volatility declined significantly in countries that went from very high inflation rates (including some with hyperinflation) to moderate or low rates, such as Argentina, Bolivia, Chile, Brazil and Peru. Still, the lower volatility of real wages translated into greater downward inflexibility and transferred the heaviest burden of the adjustment to employment, with the consequent increase in unemployment.

The volatility of real wages, however, does not entirely explain the behaviour of employment income, because of limitations in the scope of the available information, as well as conceptual limitations. Wage calculations do not generally include income from employment at small enterprises or earned by workers without contracts or own-account workers. As noted above, in these categories the share of employment has increased, and income from this type of employment is generally less stable than are wages. Their inclusion might modify existing conclusions. Partial information presented by ECLAC (2000a) shows that the income differences between skilled and non-skilled workers increased in the 1990s. Between 1990 and 1997 the gap between the labour income of skilled workers and wages in the formal sector increased 24%, and the disparity between the income of skilled workers and wages in informal enterprises rose 28%. In 1997, wages of skilled workers were 2.3 times higher than those of workers in the formal sector and 3.6 higher than those in the informal sector.

Disparities in average wages between the formal and informal sectors increased by 10% in the same period, and wages in the formal sector were 2.1 times higher than those in the informal sector. Although the wage disparities between the two sectors did not change significantly in the 1990s, wages in the formal sector were 1.5 times higher than those in the informal sector. The disparity between the formal and informal sectors tended to increase in the countries that grew the fastest and to decrease in countries in which the average income of the urban employed fell, particularly in countries where wages contracted more in the formal sector than in the informal sector. In countries with low growth, the maintenance or worsening of inequality resulted less from an increase in this disparity than from rising unemployment, declining wages and the greater capacity of the highest-income groups to defend their share of total income.

The second issue related to instability is poverty. Two observations, among others, are in order. First, poverty has followed the variations of the cycle, increasing in the 1980s, during the downturn, and declining in the 1990s, during the recovery, but without returning to initial levels. The percentage of households below the poverty line fell between 1990 and 1999 from 41% to 35.3%, still remaining above the 34.7% recorded in 1980. The percentage of indigent decreased from 17.7% to 13.9% in the same period, an improvement on the level of 15% recorded in 1980. The number of poor increased by around 11 million, even as the number of indigent fell by 4 million (ECLAC, 2001a). Instability generated not only more poor powerty, but new powerty as well.

Labour-market income is very important for households, accounting for approximately 80% of their total income. Transfers represent only 13%. In addition, heads of household continue to contribute around 70% of household income, although the contributions of other household members have risen, particularly those of women (ECLAC, 2002). This indicates that the labour market is the main transmitter of instability, while social policies, though important, play a limited role. It also attests to the importance of the incorporation of new income earners as a factor for households to overcome poverty, which, in turn, depends on employment and income opportunities.

The second observation refers to the impact of crises on the poor. Although it is proven that the effect of growth (or the lack thereof) on the poor is similar to its effect on average income earners, the intensity of crises has a differential effect, since crises of a greater magnitude have a greater impact on the poor (De Ferranti, Perry and others, 2000). This is because the poor have more limited defence mechanisms, which forces them to reduce their consumption levels or liquidate assets to cope with the longest or most intense crises.

Three observations are in order on the third area, income distribution. First, unlike poverty, income distribution has proven to be asymmetrical and less elastic in relation to changes in growth. On the one hand,

it worsens during crises but does not improve during the recovery. From 1960 to 1980, income concentration as measured by the Gini coefficient had declined from 0.53 to 0.50 on average for 13 countries of Latin America. Starting in 1980, the coefficient rose, to 0.53 in 1990 and to 0.54 around 1999. Moreover, recovery tends to benefit the highest income groups the most. Whereas the income of the wealthiest decile doubled between 1980 and 2000, that of the poorest 40% remained constant (ILO, 2002). Between 60% and 90% of inequality can be explained by the high share of income received by the top decile (IDB, 1999). Consequently, over time growth has become less effective as an instrument to reduce poverty. In the 1960s, poverty decreased 0.98% for each additional percentage point of growth; in the 1970s, it decreased 0.69%; and in the 1990s it declined 0.12% (ILO, 2002). Unlike what occurred with poverty, in almost no country of the region did the conditions of inequality improve in the 1990s. Only Panama and Uruguay showed an improvement in equity.

The second observation is that middle-income groups have been affected the most, even more than the poor. As noted, in countries where income distribution worsened, the gap between middle-income groups, on the one hand, and high-income and low-income groups, on the other, widened more because of the growth of the top decile than the decline of the lowest stratum. Indeed, this growing inequality coincided with a reduction in poverty, except in Uruguay. The result was a loss of income share by the middle strata, which garnered a much smaller portion of the increase in income, due to the worsening employment situation. The middle strata suffered the combined effect of the labour market and the change in social policy. Social policy has increasingly targeted the poorest, thereby becoming more efficient but at the expense of the middle groups, given the difficulty of transferring income from the upper groups to others (Klein and Tokman, 2000; ECLAC, 2001a).

Lastly, we need to analyse the system's loss of social cohesion. Divergent tensions have been generated by change, but they generally tend to fragment rather than to unify the social structure. Tensions are created by changes in occupational directions and the greater mobility in the labour market. Some of these directions are upward, but others are not. Undoubtedly, they are all accompanied by greater instability. Traditional processes of upward mobility are also weakened—some, because they have run their course; others, by changes in direction: in particular, the urbanization and modernization of the employment structure. This is also accompanied by social policy's reduced levelling capacity; the narrowing of this capacity has benefited the poorest but it has had a negative effect on the middle groups. This holds for the acquisition of public services (which were once free and are now the object of transactions), the differentiation in the quality of these services (due to the effect of privatization of the education and health sectors), or the cancellation of cross-subsidization between groups of different income levels and similar needs (health) (Klein and Tokman, 2000; Tokman 1998).

V

Towards risk management

In this section, I will review the spaces for intervention at different levels. The convergence of economic and ideological approaches has led to a certain determinism in the acceptance of social results that cause dissatisfaction because of the greater uncertainty and the worsening levels of poverty and equity.

This is, in fact, largely the result of the new form of operation within the context of globalization, which limits for autonomy and imposes higher penalties mistakes resulting from the trial-and-error process inherent in economic policy-making.

Moreover, little attention has been paid to a series of views that, without becoming an alternative model of operation, introduce not insignificant nuances in the use of policy tools. These innovative proposals, generally coming from academia, have increasingly penetrated governments and international institutions within a context of dissatisfaction with the results thus far obtained.[1] Hence, a space conducive to innovation has opened up.

It is also important to differentiate between possibilities for intervention according to the objectives sought. First, there is an attempt to reduce risk through preventative policies that can be promoted at either the international or the national level, and, at the national level, to promote macroeconomic policies as well as more specific policies in the field of labour regulation. Moreover, risk can also be dealt with by trying to mitigate its potential damage through insurance or social-protection policies. Lastly, when risk becomes fact those who are affected certainly deserve compensation through specific measures to provide them with income or employment or to allow their productive re-entry into the labour market.

I will address this task on four levels:

— The first refers to managing instability coming from the international sphere.
— The second deals with the most suitable macroeconomic policy for mitigating the effects of external shocks.
— The third relates to labour policies—increasingly the space for seeking flexibility in response to the accepted rigidity of macroeconomic policies and those that operate in the international sphere.
— The fourth examines social policies and, in particular, protection policies, with a view to compensating the most vulnerable groups and to "shielding" programmes essential for future development.

1. Policies to regulate international fluctuations

External volatility has traditionally been transmitted through both trade and financing. However, the lowering of trade barriers and the liberalization of capital markets have accelerated the spread of instability and deepened its effects, since its contagion among countries magnifies the procyclical nature of capital flows.

Nonetheless, there are risk-insurance and diversification instruments that allow the intensity of external shocks to be lessened and, occasionally, their effects to be distributed over time.

Countries may act preventatively to avoid allowing economic booms, associated with the entry of significant amounts of capital, to lead to eventual crises. Prudential crisis management should be implemented through a suitable liability policy and by avoiding significant price disequilibria, particularly in the exchange rate and the prices of assets. Similarly, a foreign-exchange system allowing for a certain stability and the flexibility necessary to adapt to external financial shocks may help and may also avoid the maintenance of reserves that serve as "self-insurance" during crises.

Disruptions in the terms of trade are insured against through hedging and futures transactions and, fundamentally, through the diversification of the structure of trade. Such possibilities are, however, limited in Latin America by the high concentration of exports in a few products, generally natural resources, and by the recurring volatility in the prices of those products.

Capital movements, increasingly important, have also proven to be a source of volatility and generally reinforce, rather than mitigate, the intensity of the cycle. The development of capital markets and the stronger integration of domestic markets into the international

[1] Among others, see ECLAC (2000b), Ffrench-Davis (1999), Krugman (1999) and Stiglitz (2002).

market might permit the introduction of risk-diversification instruments scarcely available today in most Latin American countries. Related to this topic, the degree of opening of the capital market continues to be debated, since experiences have been mixed and regulating capital flows has allowed for a decrease in short-term fluctuations.

At the international level, an emergency financing body should be created to serve as the lender of last resort. This role could be played by the International Monetary Fund (IMF), through its new Contingency Credit Line, which makes it possible to deal with problems stemming from financial contagion and which has not yet been used by any country. Similarly, the expansion of resources available through the temporary issue of special drawing rights would contribute to providing needed liquidity in times of crisis. Moreover, given the alternative of insolvency, it would be useful to have multilateral rules for foreign-debt renegotiation. Although moratoriums can prove costly, a mechanism agreed to at this level would allow liquidity and solvency crises to be addressed and permit private-sector participation in finding a solution, thereby distributing the costs and risks in a more balanced manner between debtors and creditors. Such a mechanism could complement rather than replace the provision of emergency funds (ECLAC, 2001b).

In the new globalization context, additional topics that may require intervention are emerging, less to diminish fluctuations than to regulate competition among countries. In particular, labour issues have been doubly important, as determinants of competitiveness and because of the effects that increased trade can have on employment, poverty and equity.

At the multilateral level, the search for a regulation mechanism to avoid unfair competition or "social dumping" has made significant headway. The possibility of linking labour and trade conditions in the event of a breach of fundamental labour principles and rights has been abandoned at the multilateral level, at least temporarily, given the risk of its arbitrary use as a trade-protection mechanism; and a universal agreement has been forged at the ILO based on the adoption of a "common minimum labour standard" of fundamental rights at the workplace. Every country involved in international trade has committed to abide by this agreement (Tokman, 1999 and 2002b).

In addition, a variety of innovative mechanisms has been introduced in free trade and economic integration agreements, particularly in Latin America. Some, such as the Southern Common Market (Mercosur), have adopted the non-hiring model and moral sanctions regarding a set of labour rights, thereby making progress *vis-à-vis* the multilateral mechanism on rights coverage with the inclusion of labour conditions and possible measures to correct violations. Others, such as the agreements between countries of the region and those of North America —(the North American Free Trade Agreement (NAFTA), the United States-Chile Free Trade Agreement—, incorporate monetary sanctions, which could lead to the suspension of the benefits of trade agreements in the event of recurrent violations of the labour laws in effect in each country intended to protect workers' fundamental rights.

2. Macroeconomic policy with a countercyclical focus

Conventional macroeconomic policies have stressed maintaining equilibria, even in a markedly more volatile context. In many cases, this means that the procyclical nature that policies assume when attempts are made to achieve equilibrium regardless of the stage of the cycle is compounded by the loss of autonomy stemming from greater integration into the international economy. This often triggers an inordinate contraction, with negative effects on employment and income.

As noted by Ocampo,[2] although macroeconomic policy has distinct national traits, controlling volatility is facilitated through the combination of three sets of policies:

- First, through consistent and flexible macroeconomic policies that avoid disequilibria in the most relevant prices and the accumulation of large debts.
- Second, through a system of regulation and prudential supervision with a clear countercyclical focus.
- Lastly, through a "liability policy" to manage the maturity of the country's debts.

In particular, for the purposes of this study, we should stress four important aspects, among others. The first refers to fiscal policy, which, due to the exclusive commitment to equilibrium maintenance, is a powerful tool that intensifies fluctuations. Today, by contrast, it is increasingly recognized that the management of this policy must aim to balance the public sector's structural position, more than its short-term position, which

[2] See Ocampo (2001) and ECLAC (2000b).

necessitates incorporating a longer-term perspective of fundamental parameters (Marcel, Tokman and others, 2001a and 2001b). This allows fiscal policy to serve as a stabilizer, lessening the danger of increasing disequilibria when short-term criteria are used.

The second aspect refers to the management of foreign-exchange policy and its relationship with monetary policy. In Latin America, particularly before the Asian crisis, exchange rates have been set, or their adjustments have been delayed, as a tool for reining in inflation. The results in this area were successful, particularly taking into account the high-inflation tradition of the countries of the region. Exchange-rate lag or rigidity meant shifting the burden of adjustment to monetary policy, in a context in which more restrictive fiscal policies faced greater political obstacles, particularly after the substantial efforts undertaken to achieve fiscal equilibrium. This triggered an excessive rise in interest rates and an inordinate economic contraction, resulting in higher unemployment.[3] The combination of instruments is difficult to predetermine and must respond, as indicated, to specific national traits. Nevertheless, for the instruments to be effective, they must have an appropriate mixture of flexibility and credibility.

A third aspect is the redistributive effects of changes in relative prices. Macroeconomic-policy decisions affect key prices and create winners and losers, leading, therefore, to changes in the distribution not only of income but, also, of assets. Macroeconomic policies that translate into price stability generally favour the poorest segments of the population. However, if authorities resort to a combination of a fixed or lagging exchange rate with excessively tight fiscal and monetary policies, that benefit may be offset by diminished income and well-being stemming from higher unemployment and lower social spending. In addition, real wages turn downwardly inflexible in response to successful efforts to control inflation, because wage changes require to be affected nominal wages. The labour-market adjustment consequently tends to be one of quantity more than of price, therefore bringing higher unemployment with changes in income distribution between insiders and outsiders.

A fourth aspect is related to the positive correlation that exists —according to Rodrik (1998)— between openness and the size of government, as measured by government spending. Contrary to expectations, openness is accompanied by more market, but also by more government, suggesting a complementarity between the two. The cause appears to lie in the need to provide social security in countries whose degree of openness makes them more exposed to risk and therefore creates a greater need to mitigate it. This conclusion, based on empirical evidence compared across countries, is also supported by specific examples of changes in the degree of integration into the global economy accompanied by higher government spending, particularly in social compensation programmes.

This occurred in the smaller European countries (Austria, the Netherlands and Sweden) that complemented trade liberalization with investment programmes, incomes policies, subsidies and transfers. The same occurred in Spain in 1986, before its entry into the European Union, and in Chile, in 1990, following the Pinochet military government. In the United States, as well, programmes were introduced that raised unemployment benefits and provided subsidies to train and relocate workers displaced by imports as a consequence of multilateral liberalization in the framework of the General Agreement on Tariffs and Trade (GATT) or, more recently, NAFTA. Moreover, in the past, not only was the growth of the welfare state in Europe accompanied by a period of rapid economic growth, but the two processes mutually reinforced one another, because of the stabilizing effect of social transfers during the cycle and social security's role in helping workers adjust to economic change.

3. Microeconomic policies for innovation and growth

The proper management of macroeconomic policy, particularly with a countercyclical focus during downturns, is a necessary but insufficient condition for ensuring the return to growth and its permanence over time. And sustained growth is a requirement for creating jobs and reducing poverty. Consequently, microeconomic policies must be adopted that promote innovation, learning and complementaries among sectors so as to raise productivity, create economies of scale and

[3] Between 1993 and 2001, the real effective exchange rate for imports to Latin America appreciated by an average of 8%, whereas annual inflation declined from close to 900% to 6% between 1993 and 2001. In the meantime, real annual interest rates rose to 21% in 1998. Only since late 1998, and particularly in Brazil in 1999, have corrections begun to be made to foreign-exchange policy and has devaluation allowed interest rates to be adjusted downward. The magnitude of the disequilibrium is illustrated by the cases of Argentina and Brazil, countries in which real lending rates reached 28% and 48%, respectively, between 2001 and 2002 (ECLAC, 2002).

reinforce the system's ability to compete (Katz and Cimoli, 2001; ECLAC 2000b).

I will reflect on two important issues related to this topic. The first is the need to invest in providing the workforce with know-how and skills. There has been a process of industrial restructuring accompanied by increased concentration; in the first stage, it has translated into the destruction of jobs but subsequently it has allowed productivity levels to recover through the incorporation of workers with a higher level of expertise. However, labour and human-resources policies have lagged behind, insofar as they were envisioned for an initial phase of restructuring with declining employment and do not provide workers with the skills required for the technology incorporated in a subsequent stage. Thus, a discrepancy arises between the carrying out of the adjustment and the creation of the conditions of stability needed to encourage investment in know-how. I will return to this in the next section.

The second issue concerns small enterprises, which provide a high proportion of employment but at the same time account for the lowest levels of protection and job security. Their behaviour in the cycle, contrary to what occurs with larger enterprises, is countercyclical; however, the manner in which their offsetting role in downturns is financed affects their ability to contribute to the recovery. The presence of less formalized labour relations and of an often-paternalistic management style frequently leads to the overprotection of employment in small enterprises. Small enterprises thus contribute to offsetting the negative effect of recession. However, once the crisis has passed, their future depends on how they finance worker retention. If, as is usually the case, they resort to high-cost indebtedness,[4] their net worth and financial situation will affect their capacity to recover; in many cases this will cause enterprises to close. It is during this period, when the rate of growth and job creation of larger companies begins to recover, that small enterprises eliminate jobs. This behaviour, which affects unemployment, tends to transfer greater risk to workers and employers who lack suitable social or insurance protection systems allowing them to remain shielded during the downturn of the business cycle.

[4] The cost of such indebtedness is high because of small enterprises' limited access to capital markets, and it is further increased by rising interest rates during adjustments.

4. Labour policies: between labour stability and unemployment protection

Labour policies may be analysed from two standpoints: first, as an important determinant of international competitiveness, and, second, with regard to direct policies for insuring against the risk of unemployment.

Regarding the first issue, the prevailing approach has stressed the search for flexibility and the reduction of costs, particularly labour costs, as ways to raise competitiveness (Tokman, 2001). The labour policies currently in effect in most countries were designed to provide a relatively high level of employment stability. Labour legislation enacted regulations to diminish the risk of dismissal and protected workers' jobs; the rationale for such legislation was mainly based on the need to provide protection and create a substitute for insurance, which markets could not furnish. The cost of these regulations has been greater rigidity and the higher cost of dismissals. Legislation was adapted to existing economic conditions, but it gradually become inadequate for the present-day world, characterized by stronger macroeconomic fluctuations, high unemployment, rapid structural change, great uncertainty and the increasing heterogeneity of occupations and workers.

This explains the growing popularity of the defensive strategy, which has ushered in a generation of labour reforms that seek to make individual employment contracts and labour conditions more flexible by reducing exit costs and introducing new, non-standard contracts as an alternative to the prevailing open-ended contract. In addition, the reforms of the individual contract are combined with the decentralization of collective bargaining, particularly in countries where negotiations are still conducted at a level higher than the company, as a means to ensure that wages are set according to productivity levels.

These reforms have resulted in increased flexibility at the expense of greater instability and less protection. The lack of protection is the consequence of both the emergence of a large contingent of workers without contracts and —although legislation did not eliminate protections in the case of non-standard contracts— of compliance with legal obligations that is, in practice, lower. Employment instability, in turn, affected incentives for investing in training and the developments of worker skills. Both factors caused the defensive strategy to run its course.

In response to the demise of the defensive strategy, in the most developed countries and in large companies

an alternative strategy emerged, which assigns priority to raising productivity, to innovation and to learning. The strategy requires investment in know-how, which in turn requires a certain degree of employment stability: employment instability does not provide employers with an incentive to invest in training, since they cannot be certain that they will reap the benefits of future productivity gains, and workers lack motivation to devote time and effort to learning, since they realize that their employment is temporary. The strategy also requires labour relations based on cooperation more than on confrontation, which have a greater chance of emerging in a framework of respect for worker rights, of opportunities for dialogue and of participation in the eventual benefits.

These strategic alternatives also affect incentives for attracting foreign investment. In recent studies, the OECD (2000) confirms that transnational capital moves more in search of skilled workers and higher productivity than of cheap labour, since low-wage workers lack the capacity to ensure the quality of the products they make. Obviously, each strategic option has a different effect on employment, poverty and degrees of equity.

The biggest challenge is to re-establish the balance between stability and flexibility, so as to facilitate the functioning of the economy in a context that requires continuous adaptation but where workers need stability, not only to diminish the uncertainty that affects them, but, in addition, to help raise productivity. In labour regulations, partly as a reaction to the excessive use of defensive strategies, innovations have emerged that attempt to balance needs for stability with needs for flexibility.

The first innovation has been to limit the scope of flexible contracts, reducing, in compensation, the rigidity of open-ended contracts. This has been done in a variety of ways: from legal limitations on the use in non-standard contracts (Spain, 1997, and Argentina, 1998 and 2000), along with the simplification of the judicial process for dismissals, in the first case, and reducing the cost and extending the probationary period, in the second, or placing conditions on the scope of such contracts in collective bargaining (Brazil, 1998).

In the Netherlands, another alternative has been the introduction of more flexible, part-time contracts, allowing the massive entry of women into the labour market and the reduction of unemployment. However, once a renewal period has elapsed, these contracts acquire conditions of protection and stability similar to those of long-term contracts. Moreover, the differences between the conditions of part-time contracts and those of customary contracts were diminished through business organizations' acceptance of the reduction of the normal workweek to 35 hours (Visser and Hemerijck, 1997). This modality has also been incorporated into the recent reform in Chile, although without agreement of the parties concerned. Another alternative has been the introduction of "negotiated flexibility", by which workers and employers agree on the characteristics and degrees of flexibility and on the compensation that they consider necessary. In some cases, the terms they agree to may even replace terms of the labour legislation.

A second innovation consists in mitigating the risk of unemployment through insurance. To this end, unemployment insurance has been established that attenuates, to an extent that varies from one country to the next, the loss of income during periods of unemployment. International experience shows that insurance serves as a substitute for protection through labour regulations: greater coverage of unemployment insurance correlates with less protection at the workplace.

Unemployment insurance was initially envisioned for dealing with short-lived, mild cyclical unemployment. It was designed to protect the income of the least-skilled workers in standardized production systems, families with a single income earner, and centralized, collective bargaining that allows wage structure compression. In addition, it was combined with social welfare, to cover risks of lost work income resulting from involuntary unemployment and to ensure a minimum level of subsistence. This public social security was justified by the consideration that information asymmetries in the market did not allow private insurance to operate efficiently.

Despite widespread adoption of unemployment insurance in the most developed countries, reforms are increasingly being introduced to make eligibility criteria more stringent and reduce benefits, which has been justified both with the need to reduce the potential negative effects and with the amount of resources needed to address the changing nature of unemployment. Among the potential distortions in the labour market linked to this insurance, we should mention an "unemployment trap", in which insurance income discourages the jobless from seeking employment, and a "poverty trap", which discourages low-wage employed workers from increasing their efforts in their work. Both factors may increase the

reserve wage and affect the equilibrium unemployment rate.

Moreover, unemployment has risen to high levels, its duration has increased and it affects less-educated workers. Collective bargaining has increasingly incorporated personalized wage incentives, which introduce tension in criteria based on "equal pay for equal work", and households have gone from one income earner to two. In the European Union countries, average unemployment rates have reached 10%; half the unemployed have been out of work for more than one year; and half are located on the lower rungs of the educational scale. In the United Kingdom, for example, single-income households represented 70% of all households in the early 1960s but declined to 30% in the 1990s, while the proportion of two-income households rose from 28% to 55%. In this context, with a different type of unemployment, the need for resources has multiplied, coverage periods have had to be lengthened, and, for their part, families have created their own self-insurance mechanisms by incorporating secondary labour into the labour market (Buti, Frank and Pench, 2000). Reforms in European countries have focused on adjusting social policies to new demographic and economic conditions and seeking alternative systems, such as the transition from pay-as-you-go pension systems to contributory systems, the replacement of unemployment benefits with employment subsidies and changes in the design of social protection to increase its efficiency.

The coverage of unemployment insurance in developing countries and, in particular, in Latin America has been limited both by the structure of the labour market as well as by the insufficiency of resources to fund such insurance. Unemployment rates at times reach significant levels and coexist with informal employment that accounts for more than half of urban employment. This means that grey areas are abundant.

Latin American countries generally devote a small proportion of their resources to active and passive labour policies. The share of GDP devoted to such policies is one-seventh that of the European Union countries and, unlike in the latter, a larger amount is appropriated for active than for passive policies. On average, the EU allocates 2.15% of GDP to financing unemployment protection, whereas Brazil, the Latin American country that devotes the most resources to this item, earmarks 0.19%. Argentina, Brazil, Chile, Ecuador, Uruguay and Venezuela have unemployment insurance or social assistance. These countries' insurance is contributory and is funded with tripartite contributions (worker, employer and government). It provides specific benefits, lasting between three and twelve months. Some countries include the obligation to receive training or accept job offers as a mechanism to reduce moral hazard. Coverage in these countries has been limited —in the years of the greatest use, it has not surpassed 7% of the unemployed (Argentina in 1994)— and insurance has resisted adaptation to the evolution of the cycle.

In addition to the negligible significance of unemployment-protection mechanisms, labour legislation has protected employment stability through high severance payments and considerable exit costs for cancelling labour contracts. An innovation within this context, introduced in Brazil, Colombia, Panama and Peru, has been to separate severance payments from companies' general reserves and to deposit them into individual accounts in workers' names. In some cases, insurance can be used not only for receiving funds in the event of dismissal but also to obtain advance payments for housing or other needs up to a given amount. Even when the cost of dismissals is not affected, the availability of a progressively large amount of resources makes decision-making easier and obviates the labour conflicts often generated over severance-payment collection (ILO, 2001).

The need to introduce greater flexibility in the labour market so as to adapt to new demands has led, as mentioned above, to reducing the cost of dismissing workers and to limiting severance payments. This process has not been accompanied by the expansion of unemployment insurance or protection, which would allow the equation to be balanced.

Nonetheless, the topic has gained ascendance on the region's labour agenda and today several countries are exploring this path. The most recent case is Chile, which in 2001 approved the creation of an unemployment-insurance system that breaks ground vis-à-vis current arrangements. It introduced a mixed system consisting of mandatory savings in (worker-owned) Individual Unemployment Accounts and a Solidarity Fund that operates as complementary funding for the payment of severance benefits. There is joint responsibility, in the sense that workers must contribute to the funding, and pressure on the solidarity component is reduced by requiring that workers exhaust their own funds before resorting to the Solidarity Fund. Funding is provided workers (0.6%), employers (2.4%, including 1.6% earmarked to the individual account and the rest to the Fund) and the public treasury (there is a complementary fiscal contribution). The arrangement

is innovative because workers may receive funds accumulated not only in the event of dismissal but also in the event of voluntary resignation, thereby creating an incentive for voluntary mobility; moreover, workers are not penalized with the loss of their accumulated funds. The cost of severance payments is reduced by counting employer contributions into individual severance accounts against such payments. Another pioneering element of the arrangement is the coexistence of a solidarity component for workers unable to save enough funds to qualify for the minimum level of unemployment benefits; and, lastly, its management is innovative, in that it introduces a single private operator to manage accumulated funds, rather than the usual multiple operators who specialize in managing specific risks.

5. Social protection for unemployment compensation

Once the employment risk becomes a reality, the unemployed must receive compensation through labour and social policies. The available instruments are generally publicly supported job creation programmes, subsidies on hiring, training and cash transfers.

Job creation programmes are carried out directly by the public sector or through the private sector, whereas subsidies are transferred to the private sector, in response to the perception that the cost of hiring is at a level that impedes hiring. Training operates by reinforcing or adapting workers' employability, and transfers compensate for the lack of income of the poorest families.

Direct job creation with public support has proven to be one of the tools receiving the best evaluations, because of its rapid effect on unemployment and because it constitutes an appropriate vehicle for expressing political will to deal with unemployment. Still, jobs of this type face a series of limitations. Expanding job-creation programmes has proven difficult because of the high resource requirements. International experience shows that government support for such jobs does not exceed between 2% to 3% of GDP. These programmes tend to be procyclical, since when more jobs need to be created, there are greater limitations on fiscal resources. Moreover, they are envisioned as temporary, yet they tend to perpetuate because of the spread of clientelism. Lastly, these programmes are of limited economic efficacy, because of "leakages" in their execution: only one of every three dollars allocated reaches beneficiaries (Hicks and Wodon, 2000; Holzmann and Jorgensen, 1999).

Training programmes also receive favourable evaluations because they help workers adapt to new needs, and because they facilitate the entry of young workers into the labour market. Hiring subsidies may play an important role, particularly because they transfer the responsibility of hiring to employers, thereby reducing clientelism, and because they generate longer-term employment for at least some of the beneficiaries, who continue on the job once the subsidy has run out. There is, however, a risk that in economic downturns these subsidies will be used to formalize a relationship with non-contracted workers already employed at a company, thereby reducing the contribution to job creation, and that in upturns they will prove redundant, because the hiring might have taken place even with unsubsidized wages.

Measures taken in response to unemployment are designed more to hedge risk than to mitigate poverty. Even so, addressing unemployment in countries that lack insurance with satisfactory coverage and where households still depend to a significant degree on the income of the head of household does contribute to mitigating poverty. From a standpoint of economic efficiency, government intervention aimed at providing social security to cover risks that private insurance cannot cover is fully justified because of the weaknesses present in this type of market. The existence of adverse selection and moral hazard constitutes an argument against private insurance, as does the difficulty of predicting the number of winners and losers in given periods or the probabilities that the risks being insured against will materialize.

Social security with universal coverage may also have important cost advantages over insurance based on private competition. Since private insurance is generally premised on establishing individual risk premiums, social security may include redistributive elements between good and bad risks, or subsidies between insureds with different payment capacities. This is important, given the recent trend of mixed insurance models in pensions as well as in health.

Although recent social security reforms seek to strengthen complementarities between public and private systems, at the same time they permit the coexistence of different logics —and, in the case of health, of different qualities of service— which segment the covered population and limit cross-subsidization between rich and poor. One system operates according to market logic and attends to the population with the

ability to pay. The lowest-income population is excluded and must be covered by the public sector, through general fiscal resources rather than with the transfers that could be made among insureds or from current to future insureds, in the case of pensions. As social security benefits become entitlements, they also turn into contingent liabilities and generate fiscal obligations. In Chile, Titelman and Uthoff (2002) project an increase in the current fiscal deficit to cover minimum and welfare pensions from 0.4% to 1.5% of GDP once the present generations retire. Also in Chile, Arenas de Mesa and Hernández (2002) calculate that, to cover the value of minimum pensions, the fiscal deficit will increase from the current 0.1% to 1.3% of GDP by 2037. The estimated deficit depends on demographic factors, on the percentage of the active population covered, on replacement rates and on required contributions. In Bolivia the current shortfall is estimated at 2.3% of GDP, and in countries such as Mexico and El Salvador it is estimated at approximately 1.8% (Titelman and Uthoff, 2002). The magnitude of the unfunded fiscal responsibility leads these authors to recommend maintaining a redistributive public pillar that will make it possible to contribute to offsetting the disequilibria and mitigating future fiscal crises.

In some cases, the public sector's participation as a provider in mixed systems becomes necessary, but in all cases it is needed as guarantor of systemic solidarity. This implies recognizing social security as a right whose access must be guaranteed for the entire population. However, contrary to the vision prevailing until a few decades ago, coverage should expand gradually, to reconcile benefits with countries' real financial possibilities. Mixed systems are also promoted for reasons of economic efficiency in benefits and resource management. At the same time there needs to be a single system for all, and the State must assume the responsibility of ensuring that this will be respected. Minimum pensions need to be provided to persons who did not attain a sufficient density of contributions during their working lives, and in health, those whose income level precluded them from financing their stages of greater risk (whether from age or catastrophic illnesses) must be protected. At the same time, similar qualities of benefits, defined independent from the provider or user in question, must be ensured. There is, then, a responsibility to properly regulate social security beyond mere financial responsibility.

Lastly, when social spending especially targeting the poor is required to act as a complement of self-insurance and as a substitute for market insurance, it should behave countercyclically. In recessions, when saving is hindered or market insurance cannot cover the broad effects of the contraction, the expansion of social spending, particularly targeted social spending, should play that countercyclical role.

Experience shows that this is not easy to do. Even when social spending increases in phases of economic growth, during downturns social spending per poor person tends to decline. This underscores a dual policy task. First, it is important to control pressure in favour of expanding outlays in growth periods, because such pressure undermines the possibility of maintaining spending in the long term. Second, in the downturn it is necessary to protect or "shield" targeted spending, since the effect of economic contraction is reinforced with the increased number of poor requiring assistance.

In general, we observe more appropriate behaviour *vis-à-vis* risk by poor households than by governments. Households tend to boost self-insurance, saving both in good times and in tighter periods. When recessions are brief or mild and are perceived as transitory, households resort to assets such as family labour to offset declining income. Only in deep, long recessions do they drastically cut back investment in health and education. Governments, by contrast, are hard-pressed to apply such a policy, not because of a lack of information or expertise but because of the interaction of political and economic restrictions that hamper the establishment of reserves in boom periods with which to weather periods of crisis. Some options to which governments can resort include introducing an insurance component to cover risks such as unemployment and social security, or borrowing on financial markets in downturns and repaying in good periods. Unfortunately, as we saw above, the current times are not propitious to the availability of funds for such purposes, since capitals markets also behave procyclically. Therefore, designing a well-conceived and funded national system is, in fact, the only policy alternative.

VI
Tensions in society

The current functioning of the economy is associated with an increase in instability and in the risks to be managed by individuals and their families. The effect transcends individual levels and is transferred to society as a whole. Tensions thereby rise, because employment as well as income instability generates uncertainty and because the dynamic and degree of social cohesion are altered. This section will focus on two dimensions of the problem. First, these factors affect the process of social homogenization, which in the past has been the vehicle for achieving individual and family progress in a context of greater cohesion. Moreover, they also affect the mechanisms that determine the possibilities of avoiding an intergenerational transmission of poverty.

1. Labour mobility and homogenization

In the past, homogenization took place through upward mobility and, in particular, through the growth of the middle groups. In the current economic setting, however, it is these groups that have borne the brunt of changing labour markets and social policy.

Middle groups were affected by government downsizing, which left many of their members unemployed. For those who managed to re-enter the labour market in the private sector, the transition from one sector to another meant trading permanent, protected jobs affording stability and protection for less stable jobs with less protection, although not necessarily a lower income. Those who kept their government employment saw a reduction in their wages and a decline in their status, given the ideological depreciation suffered by the civil service.

As public employees they had, moreover, enjoyed social protection as part of their employment. Along with other middle groups, they had been the main beneficiaries of universal and free access to public goods and services. With the loss of employment came a loss of protection, and the privatization of public services also entailed paying for such services. It is not surprising, then, that middle groups have been harmed the most by the changing income distribution during the two last decades.

To a certain extent, such a decline is inherent to the logic according to which the new model, based on privatization, operates, with the consequent effects on public employment and on the provision of public goods and services. The objective, then, is to contribute to macroeconomic equilibria in fiscal matters and in prices and, at the same time, to increase economic and distributive efficacy in the allocation of social spending. The result should be faster growth and less poverty. In successful countries, this has been the case, but the cost has been borne by the middle groups. This is because income transfers take place between those groups and the poor, since the higher-income groups are “protected” to avoid harming their productive capacity.

The results have been more efficient governments, more balanced economies, a more efficacious allocation of social spending, and a decrease in the number of poor; but also a less equal income distribution and a society in which the gaps between rich and poor are not decreasing and social integration is hampered.

2. Intergenerational transmission of poverty

Related to poverty are the mechanisms by which poverty is transmitted between generations. Poor families suffer unemployment to a greater extent than do wealthy ones; fewer of their members participate in the labour market; and, therefore, they are more exposed to the risk of a loss of income. Even in successful experiences of job growth, poverty diminishes but access to new jobs is discriminatory. Greater employment opportunities for poor families come entirely from informal jobs, whereas for the higher-income strata formal positions predominate. Informal jobs have few educational and skills requirements, while formal positions generally require university or technical studies. Children belonging to poor households exhibit a higher rate of illiteracy and fewer years of schooling; and, despite the expansion of educational coverage, there continue to be large differences between the quality of the schools attended by them and those attended by their peers from higher-income families. This disparity has even been magnified by the growing segmentation into state and private schools in which the latter, because of the type of students they attract, enjoy more adequate funding (Tokman, 2002a).

A vicious circle is thus created in which the inequality of opportunities skews access to employment. Young people from poor households, with a greater need for income and less human capital, enter the labour market prematurely. Those who find work are mainly employed in positions with lower productivity and income and with few prospects for developing a career. Consequently, poverty tends be transmitted from one generation to the next. Ensuring universal access to education and training, compensating for the additional family income that might be lost when individuals do not enter the labour market, and reducing differences in the quality of education are requirements for creating more equitable opportunities of access to employment.

VII

Towards a comprehensive vision for dealing with risk and instability

This study has analysed possible responses, at different levels, to situations of instability and high risk. For a comprehensive vision of how to address such situations we need to review, from a historic and paradigmatic perspective, the various systems that have been used for that purpose.

The most widespread social-protection model during much of the twentieth century dovetailed with a Keynesian conception of full employment and the creation of the welfare state. In a closed economy, full employment regulated by domestic demand made employment the main source of income. Jobs were stable and protected by labour legislation intended to ensure both employment stability, with contractual conditions that made dismissals expensive, as well as a balance in negotiation powers between workers and employers. For those who only managed an imperfect participation in the labour market, the welfare state incorporated systemic social protection aimed at shielding workers at different stages of their lives (in old age, through pensions) and vis-à-vis risks during their working lives (unemployment, disability, accidents and death). In particular, unemployment insurance was introduced to protect active workers who became unemployed. Given the general model according to which the economy operated, the loss of employment could only be temporary and, in general, affect a small proportion of workers. The objective of this insurance was, then, to cover those who were exposed to a risk with a low probability of occurrence and limited effects (Standing, 2000; Buti, Franco and Pench, 2000).

This model of social protection operated in much of the developed world, although with different nuances, which translated, in particular, into different combinations of labour regulations and unemployment insurance; as well as into the orientation of protection outside the workplace: focus on non-working ages (the young and old) or on the working life, both to compensate for the loss of employment (insurance) and to shorten the waiting time between one job and the next (active policies). The model did this successfully, achieving not only security but a harmonic social development in keeping with cohesion and equilibrium in social relations. It was also a source of inspiration for most Latin American countries that, although imperfectly, advanced under the same guidelines.

However, the final decades of the twentieth century demonstrated the flaws of the system, including in developed countries, which led to its questioning and to the beginning of successive reforms. This questioning became more pronounced with the change in the economic system and, indeed, with the abandonment of the objective of full employment, compounded by the need for flexibilization to operate in more volatile markets and the financial difficulties of covering more unemployed, and for longer periods, than originally foreseen. The reforms in European countries, contrary to what is often stated, have led not to a dismantling of the system but to its re-examination with a view to reducing benefits, tightening the eligibility criteria and introducing additional criteria to shorten employment-search periods.

Latin American countries once again followed the evolution of the developed countries, but magnifying both the problems and the solutions. The original design could be incorporated only imperfectly,

because, although the low unemployment levels in the region could be considered consistent with a full-employment equilibrium, the prevailing underemployment was of a large magnitude and long standing. Indeed, protection for the unemployed means a differentiation with the underemployed that is not only arbitrary but also ineffective in terms of income compensation. Similarly, funding difficulties mean that protection is focused on employment stability and that it covers unemployment, with limited coverage, in only a few countries. This has not prevented the welfare state from being questioned even more intensely than in Europe. The shift in the orientation of the economic model towards openness and integration into the international economy —which took place over a very short period and was accompanied by macroeconomic policies inspired in the Washington Consensus and aimed at achieving external account and price equilibrium— transfers the demand for flexibility to the labour markets, thereby magnifying insecurity.

The labour reforms that have been introduced have brought greater instability and a lack of protection in the workplace; hence, social protection (including unemployment insurance) faces an impossible task in a framework of financial restriction. In this context, the questioning has intensified, and the search for full employment and for systemic social protection has been bypassed, though not always explicitly. In short, the welfare state has been forsaken. However, no alternative to replace it has emerged.

How are we to deal with the situation? Although completely answering this question is beyond the possibilities of this study, I would like to make six observations to contribute to the discussion.

First is the recognition that we cannot address the current situation with nostalgia for the past. Returning to the past is neither viable nor desirable. It is not in the interest of Latin American countries to once again close their economies or to put a straightjacket on their markets—nor could they do so.

Second, I suggest reaffirming full employment as an objective. This proposal might be considered prescriptive and unrealistic, but it may contribute to strengthening the political will to pursue such an objective, which is an initial step to committing to devising policies to this end. Moreover, it establishes a social obligation vis-à-vis this objective that entails responsibilities shared by government and society as a whole, particularly employers.

Third, I suggest revising the concept of full employment to include the new types of employment that have emerged. No longer should this concept solely be associated with stable employment and permanent protection but it should also include occupations that, although less stable and affording less protection, are able to provide sufficient income for dealing with the greater risks that they entail. However, steps must be taken to ensure that these occupations comply at least with minimum quality requirements regarding fundamental labour rights and labour conditions.

Fourth, the strategy of dealing with risk and instability once persons and families have been affected is an implicit acceptance that little can be done to modify the magnitude of the risk; in addition, it strains the tasks of protection and insurance, making them very difficult to address. The idea is to reduce risk, first by acting on the levels closest to the source of instability that offer possibilities for influencing results. Adopting policies aimed at diminishing volatility from the outside, countercyclical macroeconomic policies and more suitable microeconomic policies would make it possible to contribute to risk reduction.

Fifth, the way in which progress towards market flexibility is made, particularly in the labour market, is also crucial because it determines the degree of instability and risk to be dealt with by workers and their families. Labour reforms that seek flexibilization, either by making it easier to dismiss workers or by eliminating protections, increase the demands for protection outside the labour market. Therefore, reconciling flexibilization with protection would diminish the need for unemployment insurance, and, at the same time, contribute to the creation of new jobs.

Lastly, protection systems that permit universal basic minimums to be guaranteed should be established. This might be done in a variety of ways: income transfers, unemployment insurance or other occupational hazard insurance. The effectiveness of pension and health-care coverage should also be examined. There is a public responsibility to ensure broad coverage, but, given the public-private nature of most of those systems today, it is becoming necessary to examine the two components as a whole so as to ensure universal coverage and the necessary solidarity for such coverage to be affordable.

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