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CONTENTS

Fiscal adjustment *and social* spending

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The external and internal imbalances that appeared in the early 1980s, together with the adjustment and stabilization policies applied throughout that decade in Latin America, juxtaposed the need to reduce the fiscal deficit with the need to make up for the loss of income sustained by the most vulnerable groups of the population as a consequence of the external debt crisis. This article examines patterns of social expenditure in a number of countries in the region, in an effort to determine how these policies affected the level and composition of social spending and, hence, influenced social policy. As a method of analysis, the author reviews patterns of social spending during various episodes of fiscal adjustment and maladjustment in each of these countries and compares them with the trends observed in those countries' public-sector finances. The data suggest that social expenditure was used chiefly as an instrument of fiscal adjustment, which would account for the widespread deterioration seen in this variable during the 1980s. In addition, the impact of this policy was not evenly distributed among the various social sectors but instead had a particularly strong effect on housing and education.

I

Introduction

In the course of the 1980s, Latin America underwent a number of costly adjustments in an effort to restore domestic and external equilibria in the wake of the financing crisis which had erupted in the region at the start of that decade. The net result of this process was negative in terms of both growth and social equity. Given the nature of the crisis, the income-supplementation function of social expenditure proved to be at odds with the role it was called on to play in reducing the fiscal deficit.

During the crisis, the groups which were especially at risk within the population expanded, mainly as a result of rising unemployment levels. In addition, inflation and the adjustment programmes implemented during that period eroded the working population's buying power. From a social policy perspective, social spending should have been increased during this process in order to make up for the population's loss of income. The economic adjustment exerted pressure in the opposite direction, however. At the time the crisis hit, the Latin American economies were suffering from large external and internal deficits and had sustained a sudden loss of financing capacity. The chances of eliminating the public sector's growing deficit without cutting government spending were greatly reduced by the impossibility of increasing real receipts at a time when the region's economies were plagued by recession and inflation, as well as by their loss of external borrowing power. As a result, the burden of the fiscal adjustment was shouldered primarily by non-financial government expenditure, one of whose components is social spending.

The 1980s have been analysed extensively in the literature from a macro-fiscal standpoint, and this has taught us some new lessons about the role of fiscal policy in stabilization and adjustment processes.[1] The literature has also devoted a great deal of attention to the social costs of these processes, which have sharply lowered the living standards of much of the population, as is indicated by the increase in the percentage of the population living in poverty and the deterioration observed in income distribution between 1980 and 1990.[2] Indeed, studies attempting to assess the impact of stabilization and adjustment policies on social programmes generally highlight these policies' effects on the level and composition of social expenditure.[3]

Although it is generally believed that the economic policies applied in the region during the 1980s reduced social spending without doing anything to mitigate the deterioration in the living standards of the most vulnerable groups in the population, no studies have been carried out which focus explicitly on how social expenditure patterns compare with trends in public finances during this period. Those studies that do look at trends in social spending in the 1980s tend to take a piecemeal approach in terms of both the periods and the countries they analyse. Moreover, most of them concentrate on periods during which total public expenditure was reduced. This unnecessarily limits the episodes of fiscal adjustment that are examined; furthermore, reductions in fiscal spending may not necessarily reflect an adjustment of public finances. A more appropriate approach would be to analyse trends in social spending in relation to trends in the non-financial public sector's deficit, while also taking a look at the behaviour of the various levels of government that make up the public sector.

This article seeks to evaluate the role of social expenditure, both at the general and sectoral levels, during the various phases of fiscal adjustment and maladjustment observed in Latin America in the course of the 1980s and to determine the priorities assigned to social spending as a tool of social policy and as a tool for the adjustment of fiscal deficits. This evaluation will be based on an analysis of trends in social spending and in public finances in the region.

[1] See, for example, Marfán (1986), ECLAC (1989), Frenkel (1990), and Fanelli and Frenkel (1990).

[2] See, for example, Altimir (1993), Cornia, Jolly and Stewart (1987), Figueroa (1992), Lustig (1991), Mujica and Larrañaga (1992), Pfeffermann (1987) and Grosh (1990).

[3] See, for example, Hicks and Kubish (1984), Cornia, Jolly and Stewart (1987), Grosh (1990), Ebel (1991), and Carciofi and Beccaria (1993).

II

The fiscal adjustment process in Latin America

As a consequence of the external events associated with the deterioration of the region's terms of trade, the increase in interest rates and the sudden curtailment of its inflows of external resources, most of the Latin American countries' external sectors began to run up large deficits which later spread to their fiscal sectors. These countries were therefore obliged to implement stabilization and adjustment programmes, coupled in some cases with more radical reforms that actually altered the role of the State.

The trends in public finances seen in Latin America in the 1980s were in large measure a reflection of the adjustment process undertaken in the aftermath of the external debt crisis that broke out in 1982. The duration and intensity of the fiscal adjustment process in each country were determined by the initial status of its public finances, external events and the nature of subsequent adjustment policies.

The crisis had an impact on the public finances everywhere in the region, but its effects varied in both intensity and duration from one country to the next; these differing situations, in turn, gave rise to fiscal adjustment processes of varying degrees of intensity and effectiveness. In most cases, the deterioration of public finances took place within an extremely tight domestic and external financing environment and affected both the sources and uses of public funds at the various levels of government. Public-sector revenues shrank, mainly as a result of a slump in domestic economic activity, the nature of exchange policy and the erosion of tax receipts by the inflationary processes that came into play in the early 1980s. In terms of resource use, the main impact of the crisis was an increase in the region's outward transfer of resources owing to the deterioration of its terms of trade and to the rising finance charges associated with the countries' external debt service.

Any reduction in government spending inevitably has an economic and social cost, since, in the short run, it is extremely difficult to offset the impact of a reduction or postponement of government expenditure through an increase in the public sector's efficiency. Furthermore, the existence of obligated funds endows some components of this variable with a high degree of rigidity, and any reductions that are to be made will therefore be primarily in deferrable items of expenditure. Consequently, capital and social expenditures are usually the first to be cut in the event of a fiscal emergency. In terms of government expenditure, the fiscal policy tools usually employed in Latin America for purposes of fiscal adjustment have been the adjustment of public-sector wages at a below-inflation rate, the suspension or postponement of public investment projects, and the delay of payments owed to the private sector or external agents.

1. The size and causes of the fiscal deficit

The countries of the region varied significantly in terms of their fiscal status at the outset of the 1980s. Some countries which had pursued expansionary fiscal policies –Argentina, Costa Rica and Mexico– had large deficits, while others –such as Chile, Paraguay, Uruguay and Venezuela– had balanced fiscal accounts. These differences largely determined the effectiveness of the adjustment policies implemented by the various countries during the decade.

In order to ascertain the level and source of these fiscal disequilibria, the severity of the fiscal maladjustment, its fluctuations and the main causes of the deterioration seen in the fiscal accounts were analysed for a number of countries (see table 1).

The severity of the fiscal maladjustments was measured as the peak deficit recorded by the non-financial public sector (NFPS) during a period of fiscal disequilibrium. The trend in the public-sector deficit –represented by the variation in the non-financial public sector's financing requirements (NFPSFR)– shows the presence of phases of fiscal maladjustment or adjustment. A phase of fiscal maladjustment is a period in which the NFPSFR is on the rise, while a phase of fiscal adjustment is one in which the NFPSFR is shrinking. The variation in NFPSFR is an indicator of the severity of a fiscal crisis, regardless of the public sector's initial financial position, since it can just as well illustrate the extent of the downturn occurring in a country which has moved from a fiscal surplus to a moderate or small deficit.

TABLE 1

Latin America (12 countries): Size and origin of fiscal maladjustment
(Percentages of GDP)

	Extent of fiscal imbal-ance [a]	Variation in fiscal imbal-ance [b]	Varia-tion in SEFR [c]	Variation in GGFR [d]					
				Total	TI	T	PE	GGi	SE
First phase of fiscal imbalance									
Argentina (1980-1982)	10.2	4.7	1.4	3.3	-4.7	-2.3	-4.3	2.9	-2.1
Bolivia (1980-1984)	26.6	18.8	2.8	16.1	-7.1	-5.9	7.4	1.5	-1.0
Brazil (1980-1985)	12.9	9.9	0.9	9.0	-1.9	...	-2.1	9.2	-0.8
Mexico (1980-1982)	15.6	9.0	0.5	8.5	1.3	0.9	6.3	3.5	1.1
Peru (1980-1983)	10.2	6.4	0.9	5.5	-4.8	-5.0	-0.3	1.0	-0.6
Uruguay (1980-1982)	10.4	11.8	3.0	8.8	-0.6	-1.5	7.6	0.7	5.8
Venezuela (1980-1983)	17.2	11.3	6.4	4.9	-1.1	-3.0	3.6	0.2	-0.8
Colombia (1980-1983)	8.2	5.1	3.5	1.7	-1.1	-1.2	0.4	0.2	1.4
Costa Rica (1985-1988)	6.7	5.6	...	...	...	...	...	...	0.2
Ecuador (1980-1982)	6.3	3.1	0.1	3.0	-1.7	-1.3	-1.0	2.4	0.2
Chile (1980-1984)	4.6	10.0	...	9.3	-1.2	0.2	4.8	3.2 [e]	4.2
Paraguay (1980-1984)	5.4	5.8	3.1	2.7	-0.8	-1.7	1.8	0.1	1.7
Regional average [f]	11.2	7.9	2.1	5.9	-2.3	-1.8	1.6	2.1	0.8
Second phase of fiscal imbalance									
Argentina (1987-1988)	8.3	4.8	1.5	3.3	-3.9	-2.9	0.3	-0.9	-0.8
Bolivia (1986-1987)	8.3	5.2	5.1	0.1	-2.5	-2.6	-1.1	-1.2	2.3
Brazil (1988-1990)	24.3	2.1	-2.1	4.2	5.3	...	4.4	5.1	2.2
Mexico (1985-1986)	14.5	7.3	0.9	6.4	-0.4	-0.7	0.4	5.6	-0.1
Peru (1986-1989)	7.5	2.9	6.3	-3.4	-11.7	-8.3	-11.6	-3.4	-0.6
Venezuela (1986-1987)	9.7	7.4	-3.0	10.4	-6.3	-5.9	4.0	0.1	-2.8
Colombia (1987-1989)	3.5	1.9	0.2	1.8	-1.4	-0.9	0.1	0.4	-0.5
Ecuador (1986-1987)	3.3	8.7	8.2	0.5	0.2	-0.1	1.7	-1.0	1.3
Regional average [f]	9.9	5.0	2.1	2.9	-2.6	-3.0	-0.2	0.6	0.1

Source: Cominetti (1994). Data on social expenditure: Vargas de Flood and Harriague (1993), UDAPSO (1993), Macedo and Piola (1993), Chile, Budget Department (1993), Carciofi and Beccaria (1993), IMF (several years), Central Bank of Ecuador (1993), Universidad del Pacífico (1993).

[a] Corresponds to the peak level of the non-financial public sector's finance requirements (NFPSFR) during the fiscal imbalance.
[b] Corresponds to the variation in NFPSFR.
[c] SEFR: State enterprises' finance requirements.
[d] GGFR: General government's finance requirements; TI: total income; T: tax revenues; PE: primary expenditures (total expenditure minus interest payments); GGi: general government interest payments; SE: social expenditure.
[e] Interest payments by State enterprises are included under general government interest payments (GGi).
[f] Simple average.

In order to pinpoint the sectoral origin of an imbalance, table 1 also shows the trends in the financial positions (financial requirements) of State enterprises (SEFR) and the general government (GGFR). Variations in general-government deficits are further disaggregated according to the main sources of public revenues (tax receipts) and the uses made of those revenues (primary expenditure, social expenditure and interest payments).

The table indicates that many countries suffered from severe domestic disequilibria during the first half of the 1980s. This group includes Argentina, Bolivia, Brazil, Mexico, Peru, Uruguay and Venezuela, whose fiscal deficits rose to over 10% of GDP. Somewhat smaller fiscal deficits were registered by Colombia, Costa Rica, Ecuador, Paraguay and Chile; in Chile, however, the shift from a surplus equivalent to 5.4% of GDP in 1980 to a deficit amounting to 4.6% of GDP in 1984 none the less signalled the presence of a major fiscal imbalance, since the change was equal to 10% of GDP. The table also shows that most of the countries whose public finances reflected a major imbalance at the outset of the crisis relapsed –following an initial adjustment effort– into a deteriorating trend as regards those finances which was similar in intensity to the first, although somewhat shorter in duration.

In the majority of the countries, the deterioration of their fiscal standing during the various episodes of fiscal disequilibrium was chiefly associated with changes in the financial position of general government. On average, this sector generated around three-quarters of the total downturn in a country's overall financial position, whereas State enterprises were a major factor in the deterioration of the overall public finances only in Venezuela, Colombia and Paraguay during the first episode of fiscal disequilibrium and in Bolivia, Peru and Ecuador during the second.

The general-government fiscal imbalances observed during the decade stemmed primarily from a loss of fiscal revenues (TI) and higher debt service (GGi). The fiscal situation was exacerbated in a few countries by an expansion of primary expenditure (PE); in others, government spending cuts prevented the public sector's financial status from taking an even sharper turn for the worse. This was the case, for example, in Argentina (1980-1982), Brazil (1980-1985 and 1986-1989) and Peru (1986-1989).

The reappearance of fiscal deficits in some countries after the implementation of adjustment and stabilization programmes had less to do with debt servicing than in the initial periods; instead, these deficits were brought on by external factors such as falling oil prices and by factors associated with the implementation of reactivation policies or, in some cases, the outbreak of bouts of hyperinflation.

In short, the fiscal imbalances analysed in this study appear to be linked primarily to the presence of domestic and external macroeconomic disequilibria caused by the economic crisis rather than being due to deliberately expansionary policies.[4]

2. Fiscal adjustment

The fiscal adjustment processes which were implemented varied in intensity and effectiveness, as is suggested by the reappearance of imbalances in a number of countries towards the end of the 1980s.

It has often been argued that during fiscal emergencies, adjustments should be made mainly on the side of demand (use) rather than supply (sources), because the fiscal impact of reforms or changes in the tax system has a long lead time or time lag, and public-sector rates and charges are difficult to correct during economic slumps. Moreover, when spending cuts are made during times of economic crisis, they tend to be concentrated in the capital account rather than current expenditure, due to the unpopularity and higher political cost of reductions in the latter.

Table 2 provides an idea of the scope of the fiscal adjustments made in various countries of the region and of the factors that played a part in balancing the public sector's finances in the course of these countries' fiscal adjustment efforts; as in table 1, the figures are broken down to distinguish between the contributions of State enterprises and those of general government.

In most of the countries studied, fiscal austerity measures were adopted, and both State enterprises and general government made a determined effort to shoulder the weight of the debt burden and to correct overall fiscal imbalances. Table 2 also shows that, except in Brazil, the scope of the adjustment was very considerable in relation to the levels of the original imbalances; Bolivia, in particular, carried out an extraordinary adjustment (23.6% of GDP) within a very short time. It may also be seen that, as in the case of fiscal disequilibria, the input of general government was greater than that of State enterprises.

[4] There are, however, some exceptions, including Bolivia (1980-1984), Mexico (1980-1982), Uruguay (1980-1982) and Chile (1980-1984), where a substantial increase was seen in primary expenditure. In Uruguay and Chile, however, the increase in public-sector expenditure was in large measure a reflection of changes in the social security system rather than of an expansionary fiscal policy.

TABLE 2

Latin America (12 countries): Size and origin of fiscal adjustment
(Percentages of GDP)

	Fiscal adjustment [a]	Variation in SEFR [b]	Variation in GGFR [c]					
			Total	TI	T	PE	GGi	SE
First phase of fiscal adjustment								
Argentina (1983-1986)	-6.7	-3.2	-3.5	4.6	2.5	3.6	-2.5	1.4
Bolivia (1985-1986)	-23.6	-	-23.6	14.9	14.3	-11.0	2.3	-3.1
Brazil (1986-1987)	-1.5	-0.4	-1.1	3.4	...	3.5	-1.2	1.2
Mexico (1983-1984)	-8.4	-2.2	-6.2	1.3	2.3	-7.7	2.8	-2.4
Peru (1984-1985)	-7.7	-3.8	-3.9	3.8	2.9	-	-0.1	-0.3
Uruguay (1983-1987)	-9.8	-2.2	-7.6	1.2	1.1	-7.0	0.6	-3.7
Venezuela (1984-1985)	-12.8	-5.3	-7.5	4.6	4.8	-3.6	0.7	0.4
Colombia (1984-1986)	-6.9	-2.8	-4.1	2.3	1.8	-2.1	0.3	-1.1
Costa Rica (1980-1984)	-12.2	-5.9	-6.4	1.1	3.6	-5.2	-0.1	-1.9
Ecuador (1983-1985)	-11.8	-8.1	-3.7	0.4	1.6	-2.7	-0.6	-1.5
Chile (1985-1987)	-4.3	...	-3.0	0.4	-	-3.5	0.9 [d]	-4.6
Paraguay (1985-1987)	-4.6	-1.7	-2.8	0.2	0.5	-3.0	0.3	-1.6
Regional average [e]	-8.2	-3.1	-6.1	3.2	3.2	-3.2	0.2	-1.4
Second phase of fiscal adjustment								
Argentina (1989-1990)	-3.7	-0.2	-3.5	1.1	0.4	-3.1	0.6	-0.2
Bolivia (1988-1989)	-14.4	...	...	...	...	...	...	-0.4
Costa Rica (1989-1990)	-2.6	...	...	...	...	0.5	...	1.2
Mexico (1987-1989)	-9.1	-1.4	-7.7	2.8	1.2	-2.9	-7.1	0.3
Regional average [e]	...	...	...	...	...	...	...	0.3

Source: Cominetti (1994). Data on social expenditure: Vargas de Flood and Harriague (1993), UDAPSO (1993), Macedo and Piola (1993), Chile, Budget Department (1993), Carciofi and Beccaria (1993), IMF (several years), Central Bank of Ecuador (1993), Universidad del Pacífico (1993).
[a] Corresponds to the variation in the non-financial public sector's finance requirements (NFPSFR).
[b] SEFR: State enterprises' finance requirements.
[c] GGFR: General government's finance requirements; TI: total income; T: tax revenues; PE: primary expenditures (total expenditure minus interest payments); GGi: general government interest payments; SE: social expenditure.
[d] Interest payments by State enterprises are included under general government interest payments (GGi).
[e] Simple average.

The main adjustment mechanism used by State enterprises was the reduction of allocations for fixed capital formation.[5] General government, on the other hand, took a number of different steps to boost revenues, such as correcting the prices charged by State enterprises,[6] instituting tax reforms[7] and raising fuel prices and fuel taxes.[8] At the same time, the easing of inflationary pressures helped to boost tax revenues in some cases, while rebounding petroleum prices helped along the adjustment process in the oil-producing countries.

On the expenditure side, the contribution made by general-government primary expenditure to the fiscal adjustment effort was, on average, just as important as that made by tax revenues (see table 2). Financial expenditure continued to exert some pressure in most of the countries during the fiscal adjustment phase, with an increase being seen,

[5] Devlin and Cominetti (1994) show that the adjustment carried out by State enterprises in Latin America during the 1980s was achieved by reducing investment levels.

[6] This was done, for example, in Costa Rica in 1982 and Mexico in 1983. In many of the countries, however, public-sector rates and charges were also used at one time or another as an anti-inflationary policy tool.

[7] This step was taken in, for example, Colombia (1984), Mexico (1983), Bolivia (1986), Brazil (1986) and Venezuela (1985).

[8] Such measures were implemented in, for example, Argentina, Bolivia and Peru.

overall, in general government interest payments, but general government primary expenditure contributed to the restoration of fiscal equilibrium, with this contribution being quite substantial in such countries as Bolivia, Mexico, Uruguay and Costa Rica. In most cases, the countries' adjustment programmes called for drastic reductions in general government spending, especially in public-sector wages and capital expenditure. These two items exhibit a relative degree of flexibility in fiscal emergency situations, but reductions in these areas may also have serious short-term social implications as well as generating severe growth constraints in the long run.

In summary, the data examined here suggest that, generally speaking, primary expenditure was not a significant factor in the region's bouts of fiscal maladjustment during the 1980s but on the contrary made an important contribution to the restoration of fiscal equilibria. Within this context, it may be instructive to look at social expenditure patterns during phases of disequilibrium and fiscal adjustment and, in particular, to determine whether the trends in social and primary expenditure were similar or whether social spending helped to make up for the loss of income experienced by the population as a result of the debt crisis.

III

The role of social expenditure in fiscal adjustment and maladjustment

An analysis of the performance of the Latin American economies in the area of public finances during this period inevitably raises a number of questions about the role of social policy. Did social spending help trigger the fiscal crisis? How did social spending contribute to the fiscal adjustment process? How much did social policy help to make up for the loss of income sustained by the most vulnerable groups in the population?

An attempt will be made to answer these questions on the basis of a simple exercise involving an analysis of social expenditure patterns during periods in which the non-financial public sector's financial standing deteriorated and during periods when adjustments were made to improve its financial status.

1. Social spending and fiscal deficits

The pattern of social spending observed during each episode of fiscal adjustment and maladjustment may be described as being pro-adjustment if social expenditure decreases or pro-maladjustment if it increases. Thus, during episodes of fiscal maladjustment, social spending may have helped to deepen the imbalance by exhibiting a pro-maladjustment pattern or may have helped to mitigate the imbalance and forestall even greater disequilibria, in which case it would have displayed a pro-adjustment pattern. By the same token, during phases of fiscal adjustment, the pattern of social spending may have followed a pro-adjustment trajectory and thus helped to reduce the imbalance, or may have hindered efforts to reduce that imbalance by displaying a pro-maladjustment trend. [9]

Table 3 provides an overview (in terms of numbers of cases) of the patterns of social spending observed during the period in question by breaking them down into the categories of "pro-adjustment" or "pro-maladjustment" trends during episodes of both fiscal adjustment and maladjustment. It shows that, in terms of frequency, social spending during the 1980s was a strongly pro-adjustment factor in the region during episodes of fiscal adjustment as well as maladjustment. Specifically, out of 21 episodes of fiscal maladjustment, social expenditure was a mitigating factor in 11 cases, while it helped to increase the imbalance in the other 10 cases. Likewise, in 12 of the 16 episodes of fiscal adjustment for which information is available, social expenditure exerted a pro-adjustment influence, working against adjustment efforts in only four cases.

[9] Depending on the definition and unit of measurement (units of GDP) adopted, a pro-adjustment pattern may reflect a situation in which social spending is reduced or one in which social spending increases but does so at a proportionally slower rate than GDP. By the same token, a pro-maladjustment pattern may reflect a situation in which social spending rises or one in which it decreases but does so at a slower pace than GDP.

TABLE 3
Latin America: The role of social expenditure during episodes of fiscal adjustment and maladjustment
(Number of cases)

	Pro-adjustment	Pro-maladjustment
Episodes of fiscal adjustment	12	4
Average variation in social expenditure (as a percentage of GDP)	1.8	1.1
Episodes of fiscal maladjustment	11	10
Average variation in social expenditure (as a percentage of GDP)	1.2	2.0
Total	**23**	**14**

Source: Table 2.

In terms of magnitude, it may be seen that although the average increase in social expenditure during times of fiscal maladjustment outweighed the average reduction made in this variable when it was performing a pro-adjustment function, just the opposite was true during episodes of fiscal adjustment. In such situations, not only did the number of pro-adjustment patterns far exceed the number of pro-maladjustment patterns, but the size of the contribution made to fiscal equilibrium was, on average, greater than that observed in those cases where social spending rose.

The cases of Chile (1980-1984) and Uruguay (1980-1982) stand out by virtue of the extent of the change observed in their social expenditure levels during episodes of disequilibrium, inasmuch as in these two countries this factor accounted for nearly 50% of the total imbalance. This was a consequence of special circumstances in both cases (the implementation of a new social security system and of special welfare programmes in Chile, and the reorganization of the social security system in Uruguay). As regards the significance of social spending as a mitigating factor during episodes of maladjustment, it is to be noted that the contribution made by this category of expenditure was quite substantial in percentage terms, considering its relatively small share of the non-financial public sector's total budget.

In addition, trends in social spending during episodes of fiscal adjustment had a pro-adjustment influence in a majority of cases (see table 2); the deep cuts made in social expenditure in Chile during the second half of the 1980s constitute a particularly notable case.

2. Social spending and the level of economic activity: pro-cyclical or counter-cyclical?[10]

A social policy intended to play a compensatory role with regard to income levels under recessionary circumstances should call for an increase in social expenditure when the level of economic activity declines; in other words, in the context of such a policy, social expenditure should be counter-cyclical. If, on the other hand, social spending behaves pro-cyclically under such circumstances, then the most vulnerable segments of the population will probably see a further deterioration in their economic position. An analysis of social spending and of the trends observed in the level of economic activity during periods of fiscal adjustment and maladjustment may reveal any of the following types of social expenditure patterns:

(i) Pro-cyclical and pro-adjustment social spending: this social expenditure pattern is observed when the level of activity is moving downward and the level of social spending falls by a greater proportion than GDP, or when GDP is growing and social spending tends to rise, but more slowly than GDP.

(ii) Pro-cyclical and pro-maladjustment social spending: this type of pattern emerges when the level of activity is declining and the reduction made in social spending is smaller than the drop in GDP, or when social spending increases by a proportionately greater amount than GDP at a time when the level of economic activity is on the rise.

(iii) Counter-cyclical and pro-adjustment social spending: this pattern is found when social spending is being reduced while the level of activity is moving upward.

(iv) Counter-cyclical and pro-maladjustment social spending: this pattern is seen when the level of economic activity falls while social expenditure rises.

A pro-cyclical, pro-adjustment pattern reflects a social expenditure policy that places a higher priority on fiscal adjustment than on income supplementation, whereas a counter-cyclical, pro-maladjustment pattern reflects a fiscal policy that places priority on the compensatory role of social spending and thus increases such spending when the population's income levels fall.

[10] The author is grateful for the contributions made by Emanuela Di Gropello to this section.

If, when analysing the situation in the region during phases of fiscal adjustment and maladjustment, a comparison is made between the trends in real social expenditure and in real GDP, then the role of social spending in Latin America is seen to be as shown in table 4. The figures refer to only 25 cases because in another 12 instances the trend in the level of activity was quite irregular. In those cases that did lend themselves to classification, social spending was primarily used as a tool of fiscal adjustment while its income-supplementation role was secondary. This is demonstrated by the predominance of situations in which the pattern of social spending was pro-adjustment and pro-cyclical, inasmuch as there were only three cases in which a counter-cyclical and pro-maladjustment pattern was observed.

Thus far, our analysis of the role of social expenditure suffers from a limitation: it does not tell us anything about changes in the sectoral composition of social expenditure during the period in question, which may have helped to offset short-term decreases in household income. In fact, a number of countries did implement special temporary programmes to aid the most vulnerable segments of the population. Examples include Chile's employment programme for heads of household (1982-1985), Mexico's National Solidarity Programme, the Emergency Social Welfare Fund created by Bolivia in 1986, Costa Rica's compensatory social programme (1983-1984) and others. In order to detect changes in the inter-sectoral allocation of social funds during the 1980s which may have shielded some sectors at the expense of others, we will now turn to an analysis of the vulnerability of the various social sectors based on a comparison of sectoral expenditure patterns with the changes seen in total real social expenditure.

TABLE 4
Latin America: Social expenditure patterns in relation to NFPS fiscal deficit and GDP

Role of social expenditure	Pro-cyclical	Counter-cyclical
Pro-adjustment	13	5
Pro-maladjustment	4	3

Source: ECLAC, in the press.

IV
The sectoral dimension of the adjustment

The fiscal adjustment carried out in the 1980s had an uneven impact on the various social sectors; this was, in part, a reflection of each sector's relative ability to reduce or defer expenditures and of the diversion of a portion of the demand for social services from the private to the public sector. In order to determine the extent of the protection given to, or the vulnerability of, these social sectors during the many fiscal adjustment processes pursued in the region, an analysis was made of trends in the sectoral components of social policy during the implementation of the various fiscal adjustment programmes.

Table 5 shows the number of cases in which the percentage variation in sectoral expenditure was greater (>) or less (<) than the variation in total real social expenditure or moved in the opposite direction (c). The figures indicate that the contributions made to the adjustment effort and the benefits obtained during periods of rising social expenditure were not distributed evenly among the various social sectors. Instead, the most vulnerable sector during periods when adjustments were being made in social spending levels was housing and the second most vulnerable was education, with social expenditure in these sectors falling more steeply than total social expenditure in 14 out of 22 cases and in 10 out of 23 cases, respectively. During these phases of pro-adjustment social spending, the social-security and health sectors contributed less than total social spending did to the fiscal adjustment and actually moved in the opposite direction in a substantial number of cases, i.e., spending levels in these sectors rose, and the brunt of the adjustment was therefore borne by education and housing. Likewise, during times when social spending was on the rise, the most favourably positioned sectors were social security and, in second place, health, while housing and education benefited the least. In a significant number of cases, in fact, spending levels in these latter sectors actually continued to decline even when social expenditure was expanding.

TABLE 5

Latin America: Real social expenditure patterns, by social sector
(Number of cases)

	Education	Health	Social security	Housing
	Pro-adjustment social spending [a]			
Episodes of adjustment				
>	5	5	4	6
<	5	2	2	2
c	2	5	2	3
Episodes of maladjustment				
>	5	2	3	8
<	1	2	1	1
c	5	7	5	2
	Pro-maladjustment social spending [b]			
Episodes of adjustment				
>	2	3	2	1
<	1	0	1	1
c	1	1	1	2
Episodes of maladjustment				
>	4	4	5	1
<	2	4	3	1
c	4	2	0	6

Source: ECLAC, in the press.
[a] Under the heading of pro-adjustment social expenditure (SE):
> signifies that the percentage decrease in real sectoral SE is greater than the reduction in real aggregate SE;
< signifies that the percentage decrease in real sectoral SE is less than the reduction in real aggregate SE; and
"c" signifies that the pattern of real sectoral SE is counter-cyclical with respect to real total SE.

[b] Under the heading of pro-maladjustment social expenditure:
> signifies that the percentage increase in real sectoral SE is greater than the increase in real aggregate SE;
< signifies that the percentage increase in real sectoral SE is less than the increase in real aggregate SE; and
"c" signifies that the pattern of real sectoral SE is counter-cyclical with respect to real total SE.

The social security sector consistently contributed to fiscal imbalances whenever social spending exhibited a pro-maladjustment pattern. However, the pro-maladjustment role played by this sector was also a factor with regard to fiscal revenues. The evidence points to a steep drop in the funds of a number of social security institutions in the region as a consequence of a drop in the level of payments made into the social security system during the economic crisis, due to higher unemployment and the inflation registered during that period.

In summary, a review of the various upturns and downturns in social expenditure in Latin America indicates that the housing sector has been highly vulnerable during periods when adjustments were being made in social spending levels and has also been the sector that has benefited the least during periods when those levels were moving back up. Social security expenditure, on the other hand, has tended to counterbalance downward trends in aggregate social spending during periods of adjustment and has also been the sector that has contributed the most to the expansion of social expenditure during times when it has played a pro-maladjustment role. This pattern demonstrates that even though social policy as a whole has not placed priority on social spending's income-supplementation function, changes in the sectoral allocation of social expenditure have partially offset this low priority, thus reflecting, to some extent, the welfare orientation of social policy in the 1980s.

V

Social spending in the 1980s

The strongly pro-adjustment behaviour of social spending during the various periods of fiscal adjustment and maladjustment accounts for much of the fairly widespread deterioration seen in this fiscal budget item in the countries of the region.

Table 6 illustrates the trend in real per capita social expenditure and its relation to GDP and total public expenditure in three different periods: 1980-1981, 1982-1989 and 1990-1991. The object is to assess the relevant expenditure patterns during the pre-crisis period, the crisis and adjustment phase, and the post-crisis stage.[11] Throughout the 1980s, a widespread decline was observed in social expenditure; this is true regardless of which form of measurement is chosen, although, because of the sharp swings in the level of economic activity registered during this period, the downturn appears less striking for some countries when the social expenditure/GDP indicator is used. Nevertheless, in real per capita terms, the trend in the level of social spending was clearly negative. In fact, in 1982-1989, real per capita allocations for social programmes fell in all the countries except Uruguay, and in most cases had still not regained their pre-crisis levels as of the early 1990s.[12] This situation, in the absence of radical institutional changes (with the exception of isolated social reforms in some countries) that might help to make up for the loss of resources through greater efficiency, indicates that there was probably a decrease in the population's access to State-run social services or in the quality of such services.[13] Finally, it should be noted that in 1982-1989 the share of total public expenditure represented by social spending also shrank on a widespread basis; thus, the decrease in social spending can be said to reflect a fiscal policy that placed priority on non-social sectors.

The unevenness of sectoral trends in social spending shaped a sectoral pattern of expenditure in the 1980s that tended to mirror the various sectors' relative degrees of protection and vulnerability during phases of fiscal adjustment and maladjustment (see table 7). The widespread drop in social spending in the health sector indicates that, despite its relative degree of protection during the decade, the spending cuts made in this sector during downturns in social expenditure outpaced the increases made during upturns. The greater dispersion seen in the case of the housing sector is due to the fact that this sector's share of social expenditure is very small. In the case of education, the general drop in real per capita expenditure is attributable to the vulnerability of this sector, in which wages represent a very large component of social spending (as noted earlier, wages were a widely-used policy tool during the various adjustment and stabilization programmes applied in the region). The sector that suffered the least in 1982-1989 was social security, which is in keeping with the degree of protection afforded this sector during the various phases of fiscal adjustment and maladjustment.

As a result, in the early 1990s the indicators for the social security sector were better than they had been at the start of the 1980s in almost all the countries studied. This finding, which tallies with the results of other studies on social expenditure, may be attributed to differing factors (e.g., the reorganization of the social security system in Uruguay, the increased transfers made in Chile in order to ensure the viability of its new social security system and increases in the welfare component of social security expenditures).

In the health sector, the higher real per capita levels of social expenditure observed in some countries are due to a shift in demand from private health care to free health care services as a result of the crisis. Generally speaking, there are signs of a sharp

[11] This chronological scheme has been chosen for purposes of simplicity; the actual time-frame of the crisis varied from one country to the next. For example, due to circumstances peculiar to that country, Peru did not embark upon an adjustment effort until the late 1980s.

[12] A country-by-country analysis of this variable for the entire period in question indicates that, except in Ecuador and Peru, social spending was moving upward again by the end of the decade, but this ceases to be the case when the analysis is based on averages (ECLAC, in the press).

[13] The available data indicate that in a number of countries in the region, such as Peru and Mexico, the reduction of social expenditure in the education sector primarily affected the quality of instruction.

deterioration in the quality of education provided by the public sector as well as in health care. The fact that the education and housing sectors were in a weaker position in 1990-1991 than at the start of the crisis gives cause for concern in view of this situation's possible adverse effects in terms of growth potential and the countries' chances of putting an end to poverty and marginality.

TABLE 6

Latin America: Social expenditure

	Social expenditure/GDP			Real per capita social expenditure (1985 dollars; 1980-1981 = 100)	
	1980-1981	1982-1989	1990-1991	1982-1989	1990-1991
Argentina	16.8	15.1	116.0	82.6	80.4
Bolivia	5.7	4.7	4.5	67.5	61.0
Brazil	9.7	9.4	10.8	98.7	111.1
Chile	17.7	18.7	14.2	96.8	90.0
Colombia	7.8	8.1	7.7	107.1	114.4
Costa Rica	15.2	15.2	15.9	91.9	103.9
Ecuador	10.3	8.9	6.4	82.0	60.2
Mexico	8.6	6.8	7.1	72.5	74.5
Paraguay	3.9	4.2 [a]	[b]	100.0 [c]	[b]
Peru	4.6	3.6	2.0	87.0	35.8
Uruguay	14.9	16.3	17.5	99.7	118.5
Venezuela	11.5	9.5	8.5	72.9	64.4 [a]
Regional average [d]	*11.2*	*10.6*	*10.2*	*87.1*	*83.0*

Source: Prepared by the author.
[a] 1990.
[b] These figures are not comparable.
[c] 1980-1987.
[d] Simple average; does not include Paraguay due to a change in institutional coverage dating from 1988.

TABLE 7

Latin America: Patterns of real per capita social expenditure
(1985 dollars; 1980-1981 = 100)

	Education		Health		Social security		Housing	
	1982-1989	1990-1991	1982-1989	1990-1991	1982-1989	1990-1991	1982-1989	1990-1991
Argentina	86.1	73.0	91.1	90.0	76.8	78.8	133.5	61.9
Bolivia	76.2	59.8	51.3 [a]	71.2 [a]	...	...	37.7	27.3
Brazil	143.3	120.7	116.0	127.4	95.1	119.2	58.9	53.1
Chile	85.2	74.1	90.5	94.5	102.1	102.8	87.2	119.6
Colombia	109.3	103.3	98.6	123.6	107.6	136.9	109.2	50.7
Costa Rica	75.1	85.5	78.4	108.2	153.3	168.0	191.6	43.8
Ecuador	80.0	54.0	90.2	73.3	81.1	63.5	...	...
Mexico	78.4	76.7	75.4 [a]	85.3 [a]	...	...	48.3	35.1
Paraguay	81.7	...	95.4	...	125.6	...	42.3	...
Peru [b]	92.0	77.6	88.1	75.8	...	...	32.6	7.4
Uruguay	88.5	100.5	97.0	129.2	102.0	121.7	117.4	209.1
Venezuela	79.9	58.7 [c]	85.1	79.2 [c]	71.7	83.6 [c]	51.1	44.4 [c]

Source: Prepared by the author.
[a] Includes social security.
[b] Central government budget.
[c] 1990.

VI

Summary and conclusions

In the wake of the debt crisis that hit the region in the early 1980s, a conflict of objectives arose in relation to the use of social expenditure as a tool of fiscal policy: on the one hand, there was the aim of offsetting the loss of income experienced during economic downturns; on the other, there was the goal of helping to restore fiscal equilibrium in order to eliminate a major source of macroeconomic instability. An analysis of the available information on a number of Latin American countries reveals that during the 1980s priority was given to social expenditure's role as an instrument of fiscal adjustment. This led to such a sharp and widespread decrease in social spending that as of the early 1990s the great majority of the countries studied had still not managed to bring real social expenditure back up to the levels registered in the early 1980s.

The data indicate that, in general, social spending was not a significant factor in the generation of fiscal deficits but did make a significant contribution to fiscal adjustment processes.

The reductions made in social spending during these adjustment processes were not evenly distributed among the various social sectors. The most favourable treatment appears to have been given to the social security sector, followed by the health sector, but this was to the detriment of the housing and education sectors, which proved to be highly vulnerable. As a rule, the increases made in social spending were largest in the social security sector, which registered quite a widespread rise in real per capita terms during the decade. This growth was partly a reflection of the increasing welfare orientation of social policy, as opposed to a longer-term approach aimed at furthering equality of opportunity. This latter policy was promoted less vigorously during the period in question, as is demonstrated by the generalized decline in indicators of real per capita social expenditure in the education and health sectors.

While it is true that social spending was not an important factor of fiscal disequilibrium, an important lesson regarding social spending as a component of the fiscal budget is to be learned from Latin America's experiences: a lesson which has to do with the macroeconomic constraints associated with social policy. An expansionary social policy that does not ensure reliable financing for social programmes may jeopardize a country's macroeconomic stability by occasioning the implementation of adjustment plans that may well prove to be very costly in social terms.

At the same time, the high social cost of the mounting poverty and social inequity seen in the 1980s within a context of limited social expenditure underscores the need for the countries to rework their social programmes so that public resources will be used more effectively to improve the status of the most vulnerable groups in the population and to reduce inequalities on a permanent basis. These two considerations –the macroeconomic constraints of social policy and the decline in social equity– demonstrate the importance of shaping a new paradigm that will stress the efficiency, quality and precise targeting of social expenditure.

(Original: Spanish)

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