Social vulnerability, *insurance and risk* diversification in Latin America *and the Caribbean*

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Insurance policies are required, along with other measures, to deal with the magnitude and depth of social and economic risk in Latin America. The peculiarities of insurance markets (such as the constraints of the pricing system, the intrinsic characteristics of insurance as an economic good and its dimensions as a public good, its externalities, and risk selection with its adverse effects on equity and efficiency) justify the consolidation of stable, appropriate risk diversification and financing that is oriented by the principle of solidarity, with funding either from compulsory contributions or from the national budget. This paper conducts a critical review of the postulates of so-called social risk management, which limits State responsibilities in the area of social protection to the provision of safety nets to combat poverty, favours targeted policies over universal ones, is dismissive of solidarity in insurance and stresses the responsibility of individuals to insure themselves against risk.

I
Introduction

A variety of public policies are required to cope with the depth and magnitude of social and economic risk in the region. After discussing some dimensions of this risk, the present paper analyses the peculiarities of insurance markets, considering the constraints of the pricing system, the intrinsic characteristics of insurance as an economic good and its dimensions as a public good, its externalities, and risk selection with its adverse effects on equity and efficiency. These suggest a need for insurance policies that consolidate stable, appropriate risk diversification and financing that is oriented by the principle of solidarity, with funding either from compulsory contributions or from the national budget.

This approach offers the basis for a critical look at the postulates of social risk management, which minimizes public-sector responsibility for social protection in two ways: by limiting State responsibilities to the use of safety nets to combat poverty and setting off targeted policies against universal ones; and, in respect of insurance, by undermining solidarity and stressing individual responsibility in risk insurance.

The paper concludes with some thoughts about insurance financing.

II
The magnitude and depth of economic and social risk in the region

The uncertainty and risk faced by people in the Latin America and Caribbean region include, among other things, the economic insecurity resulting from sudden drops in income, risks of an idiosyncratic kind and the possibility that these might lead to catastrophic risks, or a reduced ability to withstand shocks once these become recurrent, so that household assets may be progressively run down.[1] This is what makes them important for public policy.

The current external environment is adverse for Latin America and the Caribbean in terms of demand for the region's products and the volatility of international capital. The region can be characterized in several respects as one of high social risk. Despite positive tendencies in some countries (the steady reduction of budget deficits, the maintenance of macroeconomic balances, and restored or rising social spending, for example), economic growth has been unstable and low by historical standards. If an international comparison is made, gross domestic product (GDP) is twice as volatile in the region as in the industrial countries, while the volatility of household consumption is greater still, and has increased since the 1980s (De Ferranti, Perry and others, 2000).[2]

Social vulnerability manifests itself in various ways. In many countries, what is striking is the degree to which poverty levels exceed the average; there was a gradual reduction in poverty in the first seven years of the 1990s, but this subsequently came to a halt. With few exceptions, distribution indices have worsened. Labour markets have weakened: non-permanent waged work, the number of workers without social security

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[1] Unlike aggregate, common or covariant risks, which affect most people in particular groups alike, idiosyncratic risks affect individuals or more specific groups of economic actors. The term "catastrophic" alludes to the intensity of the risk.

[2] The volatility of GDP is measured by the standard deviation from median real GDP growth, while the volatility of household consumption is measured by the standard deviation from household consumption growth (De Ferranti, Perry and others, 2000, p. 15).

and low-quality employment have all increased. Intermediate sectors have seen a decline in their incomes or their income share, which means that it is not only the poor and indigent who are suffering from the region's volatility and the tendency towards income concentration.

A huge number of people who are not poor in income terms are, nonetheless, vulnerable. In many countries, almost a fifth of households have per capita incomes of 1.25 to 2 poverty lines, while a further 7% to 11% of households have incomes that are no more than 25% above the poverty line. Two trends have been observed in this respect, each displayed by a similar number of countries: either these strata grew during the 1990s, or they shrank, but not very significantly, the exception being the large reduction seen in Uruguay before the recent financial crisis (table 1).

In many countries, sectors that can be termed "medium-low" in urban areas (i.e., the 30% of households immediately above the poorest 40%) experienced a decline in their share of total income over the 1990s, sometimes of a similar degree to that experienced by the poorest 40% (table 2).

It is also significant that in countries where the number of poor and indigent households is decreasing, the number of households lying just above the poverty line is rising. This is the case in Bolivia, Costa Rica, Guatemala, Panama and Paraguay (table 2). When an appreciable percentage of households are subject to sharp income changes in the short term, those close to the poverty line may be the worst affected.[3]

In some cases, the beneficial effects of price stabilization on household incomes are reduced by patterns of employment instability, reflected in joblessness and the spread of insecure employment (Beccaria, 2001).[4]

The likelihood of income shocks affecting poor and middle-income households has been similar in some cases. The intergenerational effects of the strategies used by middle-income sectors to cope with such shocks, considering their tendency to recur, may jeopardize the very constitution and survival of these sectors: irrespective of their relative effectiveness in the short term, the pernicious effects of the strategies they employ may outlast the very shocks that triggered them.[5] The most common are: selling assets, reducing human capital investment (especially in the second quintile) and increasing workforce participation. In these sectors, increasing the number of hours worked or migrating are less common options[6] (Gaviria, 2001, pp. 11-13, 15 and 19).

The impoverishment of sectors that previously participated in the formal labour market and were thus able to earn adequate incomes and participate in contributory insurance schemes is redefining the tasks that the public sector needs to perform when people from these sectors move to public health service providers not linked with contributory schemes, add to the demand for public-sector education or create a greater need for programmes to keep students in the education system.[7]

In a context of trade liberalization, meanwhile, inadequate skills and constraints on the dissemination of technical progress have widened the income gap between the skilled and the unskilled. Around 2000, the average incomes of people in Central America with nine years or more of education were double or quadruple those of the unskilled.[8]

Risk management in market-oriented societies entails new public-sector responsibilities (Rodrik, 2001), and the countries of Latin America and the Caribbean are often starting out with various social development shortcomings. The economic and social risk to which people are exposed by the severity and frequency of shocks depends on highly aggregated economic variables and on the social development of the countries in the context of their political systems. The public policies concerned, therefore, have to operate on very different levels.

Where macroeconomic policies are concerned, it is essential to ensure that these are stable, sustainable and growth-oriented, and to establish strict financial regulation and oversight standards along with instruments to create greater room for manoeuvre in

[3] For the two-year period 1991-1992, a panel-type grouping of the household survey sample for Greater Buenos Aires established that movements into and out of poverty were more frequent among households close to the poverty line (Minujin and López, 1993).

[4] Measurements made using data panels constructed with household survey information.

[5] Specific survey on household responses to income shocks, conducted by the Inter-American Development Bank (IDB) in 2000 in Colombia, Ecuador, Guatemala, Honduras, Nicaragua, Paraguay and Venezuela, with a sample of about 1,000 households in each country (Gaviria, 2001).

[6] Although migration has been an important resource in Argentina recently.

[7] See Kessler (various undated papers cited in the bibliography) and Feijóo (2001).

[8] According to special tabulations created by ECLAC on the basis of household surveys in the countries around 2000.

TABLE 1

Latin America (17 countries): Household distribution by per capita income bands as multiples of the poverty line, urban areas, 1990-1999

Country	Year	Per capita income bands as multiples of the poverty line							
		0 to 0.5 Indigent	0.5 to 0.9	0.9 to1.0	0.0 to 1.0 Poor	1.0 to 1.25	1.25 to 2.0	2.0 to 3	Over 3.0
Argentina	1990	3.5	10.6	2.1	16.2	7.3	22.5	18.7	35.3
Greater Buenos Aires	1994	1.5	6.6	2.1	10.2	7.4	16.7	19.0	46.7
	1977	3.3	7.0	2.8	13.1	7.2	19.0	17.5	43.2
	1999	3.1	8.5	1.6	13.2	6.2	19.1	17.8	43.9
Bolivia	1989	22.1	23.1	4.1	49.3	9.0	16.4	10.6	14.5
	1994	16.9	24.3	4.6	45.8	9.8	19.3	10.2	14.9
	1997	19.2	22.6	5.1	46.8	9.7	17.2	11.2	15.2
	1999	16.4	20.8	5.1	42.3	10.8	8.5	11.4	17.0
Brazil[a]	1990	14.8	17.3	3.7	35.8	8.3	16.6	12.3	27.1
	1993	13.5	16.0	3.8	33.3	8.5	19.0	13.3	26.0
	1996	9.7	11.9	3.1	24.6	7.3	17.5	15.5	35.1
	1999	9.9	13.1	3.4	26.4	8.0	18.1	15.3	32.3
Chile	1990	10.2	18.5	4.5	33.2	9.5	20.3	14.3	22.7
	1994	5.9	13.3	3.6	22.8	8.5	20.7	16.6	31.4
	1996	4.6	11.8	3.4	19.8	8.5	20.5	17.2	34.1
	1998	4.4	10.4	3.0	17.8	7.7	20.0	17.7	36.7
Colombia[b]	1994	16.2	20.3	4.1	40.6	9.1	18.2	12.6	19.5
	1997	14.6	20.3	4.5	39.5	9.6	18.9	12.6	19.4
	1999	18.7	21.5	4.4	44.6	9.5	17.7	10.8	17.4
Costa Rica	1990	7.3	11.2	3.7	22.2	7.9	21.9	20.2	27.9
	1994	5.7	9.1	3.4	18.2	7.9	20.4	20.7	32.9
	1997	5.2	9.0	2.8	17.0	8.1	20.5	20.3	34.0
	1999	5.4	7.9	2.3	15.6	8.5	19.3	17.7	38.8
Ecuador	1990	22.6	28.1	5.2	55.8	10.5	16.7	8.8	8.2
	1994	22.4	24.7	5.2	52.3	10.1	19.1	9.1	9.4
	1997	18.6	25.6	5.6	49.8	10.0	19.4	10.7	10.0
	1999	27.2	25.5	5.3	58.0	7.9	16.1	7.9	10.1
El Salvador	1995	12.5	22.4	5.1	40.0	12.0	22.0	12.8	13.3
	1997	12.0	21.8	4.8	38.6	11.0	21.8	13.6	15.0
	1999	11.1	19.0	3.9	34.0	9.8	21.7	15.4	19.1
Guatemala	1989	22.9	21.0	4.3	48.2	8.5	17.3	11.0	15.0
	1998	12.9	21.8	4.2	38.9	10.9	20.0	12.5	17.8
Honduras	1990	38.0	22.7	3.8	64.5	8.2	12.0	6.5	8.8
	1994	40.8	24.5	4.3	69.6	7.6	12.0	5.1	5.8
	1997	36.8	26.0	4.2	67.0	8.2	12.5	5.9	6.4
	1999	37.7	24.4	4.2	66.2	8.2	12.9	6.4	7.0
Mexico	1989	9.3	19.8	4.8	33.9	11.0	22.3	13.1	19.8
	1994	6.2	18.2	4.6	29.0	10.8	21.8	14.4	24.0
	1996	10.0	22.2	5.3	37.5	10.7	21.3	12.4	18.1
	1998	6.9	19.1	5.1	31.1	11.0	22.0	15.3	20.6
Nicaragua	1993	32.2	23.5	4.6	60.3	8.2	15.7	6.9	9.0
	1998	30.7	24.1	4.5	59.3	8.6	15.8	7.6	8.7

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Table 1 (continued)

Country	Year	0 to 0.5 Indigent	0.5 to 0.9	0.9 to1.0	0.0 to 1.0 Poor	1.0 to 1.25	1.25 to 2.0	2.0 to 3	Over 3.0
		Per capita income bands as multiples of the poverty line							
Panama	1991	13.9	15.5	4.2	33.6	8.5	17.0	13.7	27.2
	1994	8.7	13.2	3.4	25.3	7.7	19.2	16.5	31.3
	1997	8.6	12.2	3.7	24.6	7.5	18.8	15.4	33.7
	1999	6.6	10.9	3.3	20.8	7.6	18.2	16.2	37.1
Paraguay (Asuncion)	1990	10.4	21.7	4.7	36.8	13.6	19.6	14.2	15.9
	1994	9.5	20.9	5.0	35.4	11.6	20.4	13.4	19.3
	1996	8.0	19.2	6.4	33.5	11.3	22.2	13.5	19.5
	1999	6.9	20.7	5.2	32.8	11.9	19.9	16.2	19.2
Dominican Republic	1997	11.0	16.6	4.0	31.6	10.4	21.5	15.6	21.0
Uruguay	1990	2.0	7.0	2.8	11.8	7.1	22.7	23.1	35.3
	1994	1.1	3.4	1.3	5.8	3.6	15.4	23.2	52.0
	1997	0.9	3.5	1.4	5.7	4.0	15.2	21.4	53.8
	1999	0.9	3.4	1.4	5.7	3.6	13.5	20.5	56.9
Venezuela[c]	1990	10.9	17.5	5.0	33.4	10.9	21.5	14.8	19.4
	1994	13.5	22.0	5.4	40.9	10.4	21.4	12.9	14.4
	1997	16.5	21.2	4.6	42.3	10.6	19.3	11.5	16.3
	1999	18.8	21.0	4.2	44.0	10.3	19.5	11.5	14.8

Source: ECLAC, on the basis of special tabulations of household surveys in the countries concerned.

[a] In Brazil, the poverty line was calculated by multiplying the value of the indigence line by a variable, unfixed coefficient (2.0).
[b] From 1993 the geographical coverage of the survey was extended to virtually the entire urban population of the country. Up until 1992 the survey covered about half of this population, except in 1991 when a national survey was conducted.
[c] From 1997 the sample design of the survey means that urban and rural figures cannot be separated. Figures are therefore national totals.

implementing countercyclical policies using resources raised during periods of growth and financial euphoria (Ocampo, 2001).

Productive development and labour market policies are crucial because their effects spread so widely. Simulations of the individual impact of shocks, considering the diversification of the production structure and changes in productivity, yield important findings. In Costa Rica, higher productivity appears to be a necessary condition for the trade liberalization process to have a positive impact overall, and the relationship between trade liberalization, higher productivity and poverty reduction is confirmed (Sauma and Sánchez, 2003, p. 24).

Productive development policies are closely linked to education and occupational training policies, and social risk and insurance costs will rise when education quality deteriorates and education is expanded asymmetrically. This is because an education of poor quality and limited relevance affects people's future employment prospects, while reducing the quality of human capital and the flexibility with which people can respond to change.

Although the region is at an advanced stage in the demographic transition, it still displays demographic syndromes associated with poverty and vulnerability: high fertility is the rule in the lower strata and among groups with little or no education, and fertility by age 17 has risen. The high fertility of young women (20-29) reveals a continuing trade-off between the demands of parenthood and the accumulation of educational assets or work experience (Rodríguez, 2003). Later we shall discuss the prevalence of a polarized epidemiological transition.

Insurance policies are also required to cope with the economic and social risks referred to, and the way in which they are financed needs to reflect the complexity of these markets. We shall now look at this issue, with reference to the literature on insurance.

TABLE 2

Latin America (15 countries): Level and distribution of household income, urban and rural areas,[a] 1990-1999
(*Percentages*)

Country	Year	Average income	Total income share of: Poorest 40%	Next 30%	20% below richest 10%	Richest 10%
Argentina[c]	1990	10.6	14.9	23.6	26.7	34.8
	1997	12.4	14.9	22.3	27.1	35.8
	1999	12.5	15.4	21.6	26.1	37.0
Bolivia	1989[d]	7.7	12.1	22.0	27.9	38.2
	1997	7.2	13.6	22.5	26.9	37.0
	1999	7.2	15.2	24.1	28.0	32.7
Brazil	1990	10.4	10.3	19.4	28.5	41.8
	1996	13.6	10.5	18.1	27.0	44.3
	1999	12.3	10.6	17.7	26.1	45.7
Chile	1990	9.4	13.4	21.2	26.2	39.2
	1996	13.5	13.4	20.9	26.4	39.4
	2000	14.1	14.0	20.9	25.4	39.7
Colombia	1994	9.0	11.6	20.4	26.1	41.9
	1997	8.4	12.9	21.4	26.1	39.5
	1999	7.3	12.6	21.9	26.6	38.8
Costa Rica	1990	9.6	17.8	28.7	28.9	24.6
	1997	10.5	17.3	27.6	28.4	26.8
	1999	11.9	16.2	26.8	29.9	27.2
Ecuador	1990	5.5	17.1	25.4	27.0	30.5
	1997	6.0	17.0	24.7	26.4	31.9
	1999	5.6	14.1	22.8	26.5	36.6
El Salvador	1995	6.9	17.3	25.1	25.8	31.7
	1997	7.1	17.2	24.8	26.9	31.1
	1999	7.7	16.3	25.9	28.6	29.2
Guatemala	1989	7.7	12.1	22.6	27.4	37.9
	1998	8.8	14.7	22.0	26.0	37.5
Honduras	1990	5.5	12.2	20.8	28.1	38.9
	1997	4.7	14.3	22.8	26.1	36.8
	1999	4.6	14.3	24.0	27.9	33.9
Mexico	1989	9.6	16.3	22.0	24.9	36.9
	1994	9.7	16.8	22.8	26.1	34.3
	1998	8.6	17.2	22.3	25.7	34.8
Nicaragua	1993	6.1	12.9	23.6	26.9	36.5
	1998	6.4	12.3	22.3	26.4	39.1
Panama	1991	9.5	13.3	23.9	28.6	34.2
	1997	12.0	13.3	22.4	27.0	37.3
	1999	12.2	14.2	23.9	26.8	35.1
Paraguay	1990[e]	7.7	18.6	25.7	26.9	28.9
	1996	7.4	16.7	24.6	25.3	33.4
	1999	7.1	16.5	24.9	25.8	32.8
Uruguay	1990	9.3	20.1	24.6	24.1	31.2
	1997	11.2	22.0	26.1	26.1	25.8
	1999	11.9	21.6	25.5	25.9	27.0

Source: ECLAC, on the basis of special tabulations of household surveys in the countries concerned.

[a] Households in every area of the country ranked by per capita income.
[b] Average monthly household income as multiple of the per capita poverty line.
[c] Greater Buenos Aires.
[d] Eight largest cities and El Alto.
[e] Metropolitan area of Asunción.

III
Social risk and the challenges of insurance

The welfare State is much more than a safety net; it is justified not simply by any redistributive aims one may (or may not) have, but because it does things which private markets for technical reasons either would not do at all, or would do inefficiently. We need a welfare State of some sort for efficiency reasons, and would continue to do so even if all the distributional problems had been solved (Barr, 1993).

It is not just when market mechanisms are absent or dysfunctional or break down that State action or compulsory participation in a pool of risks is important, since information asymmetries and market failures are not the exception, but are inherent in insurance markets.[9] State regulatory action, public insurance and social insurance by private-sector insurers but with compulsory financing mechanisms and regulations to ensure risk diversification are different ways of dealing with risk selection and raising efficiency in these markets, as they bring stability to insurance. When social financing is opted for, the objectives are also redistributive and it is possible to create cross-subsidies among income strata, age groups, risk groups and so on.

Information asymmetries and market failures in insurance stem from numerous factors, chiefly: adverse selection; moral hazard; complexity and lack of transparency in the nature and quality of the product (insurance and all the different types of benefits) available to the consumer; the complexity and heterogeneity of the product associated with the insurance (such as medical benefits); the externalities of consumption; and underconsumption resulting from inability to pay private insurance premiums because of low incomes or chronic or congenital diseases, in which case there will be no access to insurance even if the market exists.

[9] This can be seen from statements like the following: “Moral hazard may not be an insurmountable problem if social insurance *mimics the market as much as possible*” (De Ferranti, Perry and others, 2000, p. 42; my italics). Meanwhile, there is a huge literature, starting with Arrow (1963), on this very subject of moral hazard in the insurance market.

Of course, the amount and quality of the social protection that can be funded from compulsory contributions, the general State budget or a combination of the two will depend both on the level of economic development that makes this possible and on the fiscal pacts that exist, which also embody political and social agreements regarding the level of welfare to which citizens should be entitled (ECLAC, 2000).

Policies targeted strictly on poor sectors are not enough and, where insurance is concerned, do not allow risk to be differentiated in a stable, appropriate way, since underconsumption of insurance is a problem for large sections of society, not just the poor. This is why there is a need for insurance policies that entrench risk diversification and solidarity in different markets: the health-care market, the labour market, the pensions market, etc.

1. Insurance in the market, premiums and social value

To begin this analysis, a definition of insurance is required. What is meant by insurance are all those transactions whereby payment of a given sum entitles a person to receive another payment if certain events occur. Since all individuals are exposed to a particular set of risks, they obtain a benefit by reducing their overall risk through diversification. Insurance in the market allows risk to be transferred to an agency that is able to cope with them because of its opportunities for diversification, thus enabling individuals to engage in risky activities (Arrow, 2000, pp. 220-229). Insurance can narrow the gap between actual incomes and desired incomes in different circumstances. It is analogous to saving, which narrows the gap between income and consumption levels over different points in time (Ehrlich and Becker, 2000, p. 171).

The ideal situation for everybody would be a market in which people were free to insure themselves against any economically important event, at prices determined by the equilibrium of the relationship between supply and demand. The reality has always been far different from this; not all the forms of risk transfer that would be desirable can be carried out through the market, and this creates problems that society confronts in different ways. Since the pricing system is unable to deal properly with certain risks, its use is limited, so that market insurance is restricted in both coverage and amount. For example, the limitations of private health insurance mean that large medical expenses –the very ones it would be most desirable to insure– go uncovered (Arrow, 2000, pp. 220-229).

Certain insurance markets in the region are either non-existent or are not properly developed. In addition, though, the price/income ratio in countries where income concentration is particularly high means that the insurance needs of the population cannot translate into effective demand when earnings are low or there are spells of unemployment, factors that result in underconsumption of insurance.

Over and above the intrinsic characteristics of insurance as an economic good and the potential consequences of these, furthermore, if the values of justice and equity are linked to those of effectiveness and efficiency, then certain goods and services are defined as entitlements on the basis of these values. This is a political process: in representative governments, agreement is reached on the spheres of action and resources needed to meet social aspirations or to deal with aggregate social conditions that, in the present case, may relate to insurance (Moore, 2001, p. 30).

Both the level and the distribution of the production of social value, which expresses the joint preferences of citizens in a political system in relation to the satisfaction of an aggregate social condition and which entails particular social obligations, are determined by citizens acting in the sphere of politics rather than by consumers acting in the market. In decision-making terms, political dialogue is to the public realm what the market is to private efforts, with the peculiarity that it has a representative character, deals with what is desirable for society as a whole and involves discussion of principles and values. The resources needed to solve problems deemed to be of public interest are limited, as is the public authority or moral obligation associated with them. Thus, politics is the response of liberal democracy to the question, not resolved by analytical means, of what things should be produced for collective purposes out of public resources. The case of insurance concerns fiscal resources and compulsory contribution systems with risk differentiation (Moore, 2001, pp. 41, 43, 44 and 49).

The fact that financing is required to deal with the challenges of equity and the synergies between social development and economic development suggests a need for fiscal pacts in the countries to determine protection levels, as political agreements and economic feasibility permit (ECLAC, 2000).

The singularity of certain goods in relation to insurance also needs to be considered. It might be thought that anything subject to loss could be valued in the relevant markets and that insurance could provide for full or partial reinstatement in the form of monetary compensation (as in the case of a car that is involved in a road accident, for example). However, there are things that have no adequate market substitutes, such as loss of life, or the loss of health, with non-monetary components such as pain, disablement or suffering (Dionne and Harrington, 2000, p. 12). Because there are no perfect substitutes for some permanent sources of benefit, such as good health, there are strictly speaking no markets in these, although individuals may set a particular monetary value on them. These valuations can vary, and this is taken into account in theories about behaviour in the face of risk; for example, because it might result in a tendency for less insurance to be purchased in the market (Cook and Graham, 2000, pp. 207 and 214) and thence in a situation of underinsurance that entails individual and social costs. In these situations, the idea of compulsory insurance makes sense as a way of dealing with “free riders”.

Where health is concerned, insurance policies, the health-care systems developed, preventive health policies and a culture of health are all factors that can delay or prevent a definitive loss of good health; thence the importance of insurance, which can provide access to preventive and curative services when they are needed. Appropriate insurance can deal with reversible situations of morbidity that have insurable market substitutes, i.e., the cost of restoring health, while a lack of protection can lead to irreversible situations of morbidity for which there are no market substitutes.

2. Insurance, public goods and externalities

To gauge the importance of insurance in the region, consideration needs to be given to the public good aspects it might have, or the combination of public good and private good, or its externalities. Theory has laid down a demanding standard for pure public goods: that there should be no rivalry in consumption, i.e., no conflict whatsoever between different individuals' consumption. Since it is undesirable for individuals to be excluded from access to these goods by price, they need to be provided through other sources of income. How the market performs will depend crucially on the characteristics of the public good in terms of the likelihood of exclusion, the number of individuals benefiting from it, the existence of substantial benefits for direct consumers, economies of scale in its production, and the legal and institutional framework within which transactions take place. This complex of factors is held to make generalization difficult, beyond the observation that private markets tend to underprovide public goods and overprovide public ills. Many of the services made available by governments have a mixture of public and private provision or financing. Political decisions about the provision and financing of public goods all have their own distributive implications and are mingled with considerations of economic efficiency. It is rightly pointed out that these processes need to be better understood, with political variables being incorporated into normative models of public good provision (Oakland, 1991, pp. 492, 509 and 533).

Net social product is increased when other benefits exceed those obtained directly by individuals from a transaction, so that a subsidy is required to cover externalities not reflected in market demand; fiscal instruments can be used to take account of externalities (Musgrave, 1985, p. 11).

Against this background, it needs be explained why it is important for insurance to have redistributive objectives and pursue stable risk diversification by means of compulsory contributions or public financing for the indigent.

Two important considerations relating to the social impact of individual welfare justify society in using the public budget to guarantee citizens access to particular social services as merit goods. It needs to be understood that, because of the externalities of individual welfare, there is a close relationship between this and social welfare. Nor can society and individuals opt out of public or quasi-public goods, as one of the singular characteristics of these is the impossibility of ceasing to consume them, or at least to consume their externalities, without leaving the community that supplies them (Hirschman, 1970). This is manifested in many and various ways: the private lives of citizens, civic security and the competitiveness of nations in an open, globalized world are in practice affected by the quality of public health and education, and by the degree of social integration.

It is also relevant to consider both the microeconomic dimensions of certain aspects of insurance and the macroeconomic repercussions to which it can give rise. When wages are flexible, the cost of the benefits provided by an employer is partially transferred to the worker in the form of lower wages; if workers do not value these benefits as much as the earnings foregone, they may seek work in the deregulated sector, where all remuneration is monetary. This can occur when the provision of social security or medical benefits is very inefficient or the link between benefits and contributions is very weak, or if some member of the family who is already working in the formal sector provides cover for the whole family. Along with information asymmetries and weak property rights, poor quality and inefficiency in social security systems have been identified as factors in the isolation of microenterprises from the market (De Ferranti, Perry and others, 2002, box 5.5 and p. 145).

From the standpoint of this paper, these conclusions suggest an argument in favour of insurance reforms, considering that social security failings or poor medical benefits are negative externalities that do not create an adequate incentive for deeper labour markets.

On the subject of externalities, the strategies used by poor and middle-income households to cushion shocks (when social safety nets are inadequate and insurance markets undeveloped) may in some cases be effective in protecting consumption levels, but are not necessarily very productive. This being so, inadequate or non-existent insurance affects both the allocation and the availability of household resources.[10] Conversely, it is worth reflecting here on the positive repercussions that insurance may have for economic growth: assuming that saving generates growth and that there is a close link between household and national saving, it is interesting to consider insurance as a determinant of household saving, with macroeconomic repercussions. If each individual is not an island, social insurance is one of the mechanisms that, by diversifying risk, acts to smooth and stabilize fluctuations in consumption, thus overriding independent individual strategies of saving and dissaving over time (Deaton, 1997, pp. 335-400).

[10] This is a reformulation of points made by Baulch and Hoddinott (2000), pp. 19-21.

3. Equity, risk selection and social financing

We should not overestimate the potential of informal or market-based risk instruments for coping with idiosyncratic risks: without proper risk diversification, exclusion and inequality will occur.

In the absence of regulation and premium restrictions, the norm in competitive markets is for medical plans to set premiums that are adjusted to individual risk: this is what is known as the equivalence principle. Plans vary according to observable risks, and packages of benefits are designed to attract particular types of risks. When the costs of the risk are very high, plans may exclude some existing medical conditions from the coverage or deny insurance to high-risk individuals (Van de Ven and Ellis, 2000, p. 759).

To reconcile efficiency with considerations of justice and equity, there is a crucial place for risk adjustment mechanisms that spread risk widely. The shortcomings of these mechanisms mean there are always incentives for risk selection in medical plans in competitive markets: the better the explicit subsidies for major risks, the less will be the trade-off between the objectives of efficiency and justice. Risk-adjusted subsidy systems seek to provide explicit subsidies for high-risk individuals; conversely, regulation of plan design and limits on the extent to which individual contributions may vary are a way of having low-risk individuals implicitly subsidize high-risk individuals (Van de Ven and Ellis, 2000, pp. 762 and 763). Information asymmetries mean that entry and transaction costs are high and may lead insurers to set high policy rates (Belli, 2001, p. 21).

As for pensions, in pension systems that are individually funded, either wholly or in part, risk is borne individually and differentiated by sex. The bias against women that results from these systems has had unexpected consequences, particularly as regards the welfare of women and their children, and the family economy.

There are a number of arguments for redistributing risk. First, there are considerations of equity, the idea being that the elderly, the chronically ill and other high-risk groups should be guaranteed decent coverage. Second, there is a life-cycle argument: young people or those whose health risk is low are willing to pay out more than they get back because in future they may benefit in turn from subsidized coverage. Even in a static situation, they may be willing to provide subsidies as a way of obtaining coverage that is closer to their preference for a comprehensive insurance contract (Belli, 2001, p. 18; ECLAC, 2000).

Annual contracts that are varied in accordance with a person's observable medical condition (e.g., using "experience rating", which takes account of new medical conditions or existing illnesses) go against the idea of intertemporal insurance, i.e., the right for people to buy future medical coverage at moderate cost even after they have fallen ill (Cutler and Zeckhauser, 2000, p. 564). Looked at from a dynamic perspective, benefits that are spread across generations or among people with different health conditions also represent intertemporal individual benefits to differing degrees. Furthermore, compulsory saving by the healthy against periods of acute or chronic illness has positive microeconomic and macroeconomic effects, as it increases household saving and smoothes consumption.

Social financing of health insurance has redistributive objectives, since it allows for cross-subsidies among income, age and risk strata. Such financing normally comes from compulsory contributions or the national budget. The principle of solidarity that gives effect to the universality of insurance enables account to be taken of different aspects that are not properly dealt with by the price system. For example: individuals should not have to meet all the costs associated with their current risk structure; protection is needed against risks relating to goods (such as sound health) that do not have an adequate market substitute; market prices do not reflect the social opportunity costs or externalities of private consumption and the public good aspects that this consumption may have; there is a need to address the underconsumption associated with low incomes or high individual risk, when there is no access to insurance even where the market exists. This provides a way of correcting externalities, since the benefit from the insurance accrues not only to the person taking out the policy but also to society, which benefits from externalities of different kinds: a healthy population, fewer social upheavals, etc.

Social insurance based on solidarity principles provides a way of controlling the efficiency with which resources, financing and provision are allocated, i.e., efficiency in pursuit of both microeconomic and social objectives, along with equity (ECLAC, 2000).

We have already seen that when insurance is voluntary, the equivalence principle generally leads to exclusion, and the conditions of unregulated private insurance inevitably result in explicit exclusion (e.g., of those with chronic or congenital diseases) or high premiums, deductibles or copayments which represent barriers to entry.

Compulsory insurance, conversely, by including and retaining people at low risk, makes it possible to operate by a logic different from that of private insurance and achieve stable risk differentiation. Social insurance may be run by private-sector insurers; its financing may come from compulsory premiums paid by workers and employers or by workers only, or from general taxation; but in either case its logic is substantially different from that of private insurance, as it breaks the identity between individual risks and premiums and establishes risk coverage on more general terms, so that it can include some who are not normally covered by individual insurance policies (Barr, 1993, pp. 123-128 and 308). Generally speaking, compulsory insurance operates with a long-term perspective: because guarantees are applied generally and not to subgroups categorized by risk, individuals are not reclassified if their risks increase (Arrow, 1963, p. 904).

Stable risk differentiation, which has obvious effects on equity, also affects efficiency. Adverse selection phenomena reduce the latter and in extreme cases can result in the bankruptcy of insurers, the so-called "death spiral" (Cutler and Zeckhauser, 2000, pp. 606-625; Cutler, 2002, pp. 83-86).

From an individual point of view, subsidies are dynamic, since individuals will provide or receive subsidies over their lifetimes as their risk levels vary. The equivalence between the price of insurance and the degree of risk is then established at the system level rather than at the level of the individual premium, within the framework of what can be very diverse public-private combinations.

The magnitude and depth of the region's social and economic risk raise doubts about its fiscal capacity for dealing with the challenges of social risk. Redistributive instruments, with stable risk diversification in insurance mechanisms and the solidarity of compulsory financing, help increase financing capacity.

For those who are too poor to afford social services and protections on their own, social financing out of the public budget ensures that solidarity will not undermine the financial soundness of the saving and insurance functions carried out by the institutions involved with these services.

Meanwhile, the way idiosyncratic risks can turn into catastrophic risks also signals a need to consolidate universal, socially financed health policies in the region. Given the region's advanced stage in the epidemiological transition, the challenges come from chronic and degenerative diseases, which are costly and for which preventive policies are required. The challenge is to find appropriate financing methods and to create health systems whose providers form efficient referral networks in different public-private combinations, as circumstances require.

In the region's polarized epidemiological transition, it is among the poor that morbidity and mortality rates are high for both pre-transitional and post-transitional diseases. But idiosyncratic health risks can become catastrophic for sectors with good incomes as well, owing to the high cost of some chronic and degenerative diseases; this highlights the importance of risk diversification, solidarity and the regulation of exclusion. Consequently, while immunization, public health campaigns and preventive measures to safeguard the health of mothers and infants are indispensable, prevention cannot be the long-term focus of efforts, nor should concern about insurance for catastrophic risks be limited solely to the effects these risks have on the poor, whatever some postulates of the World Bank (2000) maintain.

One important aspect of insurance markets are information asymmetries. The information needed to make rational choices that take the nature, quality and price of products into account often cannot be used even if it is available, as it is complex and therefore not well understood. There are limitations of knowledge, time, judgement or power, or considerations of other kinds come into the decision. Power and knowledge, by and large, are closely linked to socio-economic status (Barr, 1993, p. 296). In situations of uncertainty, information becomes a commodity that is most likely to be possessed by those who can pay for it and benefit most from it (Arrow, 1963, p. 946).

Given the complexities of the insurance market, then, it is rash to make assertions as all-embracing as this one: "The critical difference between market insurance and self-insurance is that the former uses pooling to spread risk across individuals" (De Ferranti, Perry and others, 2000, p. 38). The following analogy is likewise confusing: "Under one rather strict interpretation, the public policy analogs of the individual's insurance and self-protection problem are *social insurance* (government actions to augment market insurance and self-insurance) and *social protection* (government actions to augment self-protection)" (*ibid.*).

With social safety nets, compulsory contributions and the solidarity principle in financing are vital, as they increase resources, make risk diversification fairer and more stable and allow cross-subsidy to take place. They also inculcate a sense of civic responsibility for the needs of others[11] in a system of insurance and social protection that, by attenuating risks and raising the level of welfare and certainty, foster simultaneously social cohesion, civic rights and international competitiveness.

4. The fiscal costs of risk selection and individualized insurance

Pro-marketeers often establish spurious relationships between the privatization of welfare systems and benefits to the public finances, the argument being that the latter will be freed from the obligations associated with the welfare State. The situation with privatization and the interaction between market insurance and fiscal responsibilities, however, prove far more complex when the more radical experiences of the region are analysed.

Discarding the principle of solidarity and compulsory insurance systems which spread risk widely, and promoting individual insurance without regulating adverse selection, has entailed large fiscal costs and entrenched inequality in the region. This is very well illustrated by the current discussion in Chile about a social health fund to overcome the *sui generis* duality of a health system funded by compulsory contributions which allows people to opt for public- or private-sector provision but which, despite being compulsory, is governed by a dual logic. The public sector operates on the principle of solidarity, while in the private sector the benefits and pricing of individual plans are adjusted annually by the risk level of the insured in accordance with sex, age and state of health. In this context, with no barriers to access, the public sector is the reinsurance instrument of the health insurance institutions (ISAPRE), which are private.

Chile has also had a pension system reform. There is now a private-sector defined-contribution system of individual accounts in which there is no element of redistribution among contributors. After two decades, it is proving difficult to consolidate coverage of the population. Lower-income workers are more likely to remain outside the pension system. A great fiscal effort has been required to finance the transition from the old system. The operating costs of the new system are high, and although it has helped develop the capital markets, its direct effect on productive investment seems to have been modest. Given the number of workers employed in activities where coverage is discontinuous and the frequency of episodes of unemployment and underemployment, it is likely that a large proportion of subscribers will ultimately qualify for State-funded social security or minimum pensions. Differentiation by sex in actuarial pension calculations results in lower pensions for women, and this affects subsidiary fiscal contributions (Uthoff, 2001, pp. 35-36; Arenas de Mesa, 2000).

IV

The social risk management proposal and its implications for the region

As part of the thinking about economic and social risk in the region and about insurance markets, the social risk management proposal for Latin America put forward at the beginning of the millennium is important, as it combines a particular outlook on insurance policies with comprehensive proposals for social policy.[12] Although its influence on public policy design may be limited by the rather hermetic terminology employed, it is worth analysing this proposal because of its paradigmatic ambitions, in respect not only of insurance policies but also of the struggle against poverty and the delimitation of the public sphere, where it minimizes the responsibility of society for dealing with economic insecurity. Unlike the reductionist approach to targeting policies that emerged in the wake of structural adjustment,[13] it

[11] This in turn requires mechanisms to discourage different forms of moral hazard behaviour.

[12] This analysis is essentially based on six documents: Holzmann and Jorgensen (2000), World Bank (2000 and 2001) and Holzmann (2001). Similar positions in a wider context are taken in De Ferranti, Perry and others (2000).

[13] The reductionist approach gained ground in the 1980s when bodies such as the World Bank, as part of proposals to privatize

attaches importance to the causes of poverty and makes use of insurance terminology.

1. Delimiting social policy

The analysis of social risk management rightly points out that all individuals are vulnerable to numerous risks of different kinds, and it interrelates risk, risk exposure and vulnerability. A risk is an event that may damage a person's welfare and that is uncertain as to its timing and the extent of the harm it may cause. Exposure is the likelihood of a risk occurring. Vulnerability measures resistance to shocks, the likelihood of these resulting in a loss of that welfare which is first and foremost a function of household asset levels, insurance mechanisms and the severity and frequency of the shock concerned (World Bank, 2000, p. 2). A social safety net is defined as public action that helps individuals, households and communities to deal with risk and that supports the poorest; such action should create mutually supportive relationships with the areas of education and health, in pursuit of human capital development (World Bank, 2000, p. 31).

Setting out from the subject of risk and insurance, a comprehensive social policy proposal is formulated. This combines three fundamental positions and proposes a public-private combination whose character and delimitations are functional to them: the social welfare responsibilities of the State are confined to the struggle against poverty; risk insurance is designated as an individual responsibility; and solidarity in risk diversification is essentially ruled out.

In these terms, individual insurance in the market, the use of safety nets to provide services to the poor and targeting as opposed to universality all go to make up a social policy strategy that assigns a minimal role to the public sector in social protection, places the financing and provision of the remaining social welfare-related services in private hands and once again departs from the solidarity principle in financing.

Thus, an analogy can be drawn with the reductionist targeting proposals first put forward in the 1980s, which set out from the issue of poverty to propose a similar paradigm for social policy.

2. Poverty, risk and social policy

Rather than helping people to deal with risks, it is proposed that policies should seek to reduce and mitigate these. The poor are more vulnerable because they are more exposed, have little access to assets and are ill-equipped, in terms of capabilities and resources, to administer those they do have. For the same reason, they are supposedly risk-averse[14] and have little opportunity to diversify risks, engage in high-yield activities or participate in appropriate formal and informal arrangements. Furthermore, their self-protection mechanisms are expensive and inefficient, reduce and impair their fragile human capital and result in chronic poverty with negative long-term and intergenerational effects (World Bank, 2000, pp. ii, iii, 6, 17, 20, 26 and 27).

Thus, by contrast with the reductionist targeting proposals of the 1980s and 1990s, which centred on the symptoms of poverty rather than its causes, this approach deals firmly with causes.

There is continuity, however, as regards the action of the State in the area of social welfare. To create human, physical, natural and financial assets for the poor, it is proposed that social spending on basic services should be increased and that guarantees of service access, quality, choice and follow-up should be provided (World Bank, 2000, pp. 8, 15, 19, 32, 34, 38 and 40). But the poor are treated almost as the sole target group of social policy, while State action is considered synonymous with safety nets, understood not necessarily as a broad social network but as a modular system of programmes operating flexibly as

social policies and limit solidarity in their financing, called for targeted programmes to concentrate public social spending on the most vulnerable groups and for the dismantling of universal services, which were branded as undesirable en masse by the analytical twist of extrapolating the regressiveness of programmes such as pensions to universal entitlements generally. An all-embracing view of social policy was elaborated: whereas universal provision was very costly and inefficient, targeting would enable governments to reduce poverty more cheaply and effectively. As regards sectoral morphology, countries were urged to strengthen primary health care and primary education at the expense of the other levels. Last but not least, the emphasis on temporary safety nets, which were supposed to cushion the impact of adjustment programmes, shifted interest from the causes of poverty, a subject that had received attention in the 1970s, to its symptoms. The controversial, radical nature of this approach led to debate even within the World Bank itself (essentially at a technical level), and its global view of social policy has been eroded by considerations of very different kinds, formulated even within the World Bank as well as in other bodies (Sojo, 1990 and 1999).

[14] The idea that risk aversion is a specific attribute of the poor is misleading, particularly since it is a key assumption of insurance theory that people in general are risk-averse, which is why insurance makes sense.

specific patterns of risk require. This system complements existing arrangements in an appropriate mix of public- and private-sector providers and includes schemes and instruments (such as social funds, microinsurance, health insurance, pensions, unemployment insurance and social assistance programmes) to support both immediate consumption and the accumulation of physical, social and human assets to provide a way out of poverty.

Safety nets should be created before crises or upheavals occur, and should be permanent if they are to help prevent and manage risks, whether by reducing or cushioning them. They should also help support those who are at risk of poverty, preventing them from suffering irreversible harm and broadening political support for programmes of stabilization and reform (World Bank, 2000, pp. 40, 135, 147, 166, 169 and 170).

Where Latin America is concerned, the proposal takes an excessively positive view of social funds, which are described as tried and tested products for policy makers that have yielded positive results in terms of targeting, impact, comparative advantages and cost. It is claimed that they have begun to address the causes of poverty and not just the consequences of structural adjustment, and their impact is even exaggerated, as they are described as prevalent in the region (World Bank, 2000, pp. iii, vi, 14 and 15).

This view of social funds largely contrasts with the findings of the interesting review carried out recently by the World Bank itself, which questions, circumscribes or qualifies certain characteristics held since the 1980s to constitute the advantages of these funds, and which proposes changes to the World Bank policy approach in this area. This review does not see any trade-off between supply- and demand-oriented policies and it stresses the need to consider the specific institutional variables of each country so that funds can be positioned strategically (avoiding short-termism or isolation) and sustainably, complementing the relevant institutions without blocking policy reform (World Bank, 2002, pp. 45-50).

The contents of this review largely coincide with different criticisms that have been made of the actual performance of these bodies: their underfunding relative to traditional social security schemes or programmes prior to adjustment; their limited repeatability and continuity, owing to the large salaries paid to their managers, the good quality of their administrative infrastructure and their relative dependence on copious external financing; their low coverage, so that they have little impact on poverty reduction, job creation or income redistribution; their inadequate linkage with sectoral policies; their targeting difficulties; the sustainability problems of the projects undertaken; the inequalities resulting from demand subsidy; the poor quality of the jobs created (which tend to be temporary and low-skilled, pay less than the poverty line and have a strong gender bias); and failure to spread the organizational innovations achieved (Godoy and Rangel, 1998; Cornia, 1999).

The social risk management proposal likewise attributes very positive characteristics to informal risk insurance, also known as microinsurance, failing to give due weight to information asymmetries in unformalized relationships and leadership styles and to the constraints represented by the tendency of the poor to favour present consumption owing to the pressure of need (Holzmann and Jorgensen, 2000, p. 10; World Bank, 2000, pp. vi, 25, 26 and 31).

Overestimating the supposedly positive features of informal insurance mechanisms, which at bottom are evidence of social vulnerability, may prevent due stress being laid on the need to move towards formal insurance and on the conditions that would gradually bring this about.

In the developed countries, modern social protection institutions originated partly in mutual insurance organizations, in cooperatives where people saved for consumption and home ownership, and in unions and friendly societies (Norton, Conway and Foster, 2001).[15] And without going further afield, the quasi-public health insurers known as *obras sociales* and *mutuales* in Argentina and Uruguay had a similar origin.

3. Market insurance

Public-sector schemes in developing countries are judged to be relatively few and limited in coverage, mainly owing to fiscal constraints and low formal employment. Insurance markets are described as almost non-existent, owing to problems of information asymmetry and constraints on contract enforcement,

[15] In Britain, for example, these civil society institutions, which played a vital role in constructing social capital during industrialization, shaped an organizational culture and ideology that contributed to the growth of the labour movement, representative government and the welfare State, which took on a wide range of social protection functions (Norton, Conway and Foster, 2001, p. 44).

and the proportion of informal employment is pointed to as evidence of the importance of informal arrangements where risk is concerned (Holzmann and Jorgensen, 2000, p. 10; World Bank, 2000, pp. 25 and 31).

The Latin America and Caribbean region is considered heterogeneous as regards income and the existence of social risk management mechanisms, and it is suggested that many countries' public-sector mechanisms are of the type developed in the Organisation for Economic Co-operation and Development (OECD) countries; the proposal for this region combines a variety of components. Firstly, the importance of informal risk mitigation mechanisms is stressed, given that the formal-sector workforce still averages only about half the total. It is then proposed that these countries lay less emphasis on government-provided risk mitigation mechanisms (and the contribution rates for social security programmes they entail) and informal provision, and that they emphasize and promote market-based risk mitigation instruments. In other words, they should move away from the left and right sides of the social risk management matrix (table 3) and make "vertical moves" within it so that they can attend more to risk reduction. They should also strengthen safety nets for potential crisis situations (World Bank, 2001, p. 70).

These propositions are subsidiary to the insurance proposals centring on individuals, which clearly define the sphere of public action and risk diversification, as the following analysis sets out: "With an approach that is individual-centered, the need for government arises only where markets fail and social policy formulation is based on minimalistic and not ad hoc principles. The role of government here –driven by efficiency concerns in an environment of risk– is to augment markets; that is, to facilitate insurance and self-protection by providing instruments if markets for them do not exist (for example, in the case of unemployment insurance), or through interventions to improve the quality of instruments if individuals are using inferior modes of insurance" (De Ferranti, Perry and others, 2000, p. 42).

With this approach, government "social insurance" measures to broaden risk diversification are essentially policies to increase market insurance; consequently, the social insurance measures that are supported (such as disability insurance) are very limited.[16] Compulsory schemes without risk diversification should thus increase self-insurance, and social protection policies that facilitate human capital acquisition should increase self-protection (De Ferranti, Perry and others, 2000, p. 42).

As regards risk diversification in the insurance market, compulsory participation in risk pools is accepted as desirable to avoid problems of adverse selection, but is held to be relevant only when there are no market mechanisms or these collapse or become dysfunctional (World Bank, 2000, p. 25; Holzmann and Jorgensen, 2000, p. 10).

Such risk diversification is discouraged and contrasted with market insurance. Finally, risk is best coped with by a combination of market insurance, self-insurance and self-protection. Policy makers should recognize this, and note especially that the insurance market with risk diversification is highly failure-prone. The best solution is usually to correct and complement the market, rather than replacing it. Thoughtful regulation is vital for this, whether in labour or financial markets or in health services (De Ferranti, Perry and others, 2000, p. 123).

This reductionism in social policy –which limits public responsibility for social protection to safety-net policies targeted on the poor, and which in this case promotes individual insurance, rejecting the principle of solidarity in a social insurance regime or accepting risk pooling through compulsory contributions only at the margin– once again puts off the vigorous social policies and adequate social investment that are needed if Latin America and the Caribbean are to participate more effectively in a globalized world, with greater social integration and well-being. Although social investment funds and microinsurance are appropriate in certain circumstances, a public policy that is reduced to such instruments will not deal with today's economic and social risk and the challenges of economic and social development in all their magnitude and depth.

[16] Unemployment insurance is considered in De Ferranti, Perry and others (2000), however; this would have very great fiscal implications in Latin America, with its weak labour markets and volatility.

TABLE 3

Strategies and arrangements of social risk management: matrix and examples

Arrangements and strategies	Informal	Market-based	Public
Risk reduction	• Less risky production • Migration • Proper feeding and weaning practices • Engaging in hygiene and other disease-preventing activities	• In-service training • Financial market literacy • Company-based and market-driven labour standards	• Public labour standards • Pre-service training • Labour market policies • Child labour interventions • Disability policies • Good macroeconomic policies • AIDS and other disease prevention • Legislation to remove gender inequalities in property rights, marriage and access to labour markets
Risk mitigation			
Portfolio	• Multiple jobs • Investment in human, physical and real assets • Investment in social capital (rituals, reciprocal gift-giving)	• Investment in multiple financial assets • Microfinance	• Multipillar pension systems • Asset transfers • Protection of property rights (especially for women) • Support for extending financial markets to poor people
Insurance	• Marriage/family • Community arrangements • Share tenancy • Tied labour	• Old-age annuities • Disability, accident, and other personal insurance • Crop, fire, and other damage insurance	• Mandated/provided insurance for unemployment, old age, disability, survivorship, sickness, etc.
Risk coping	• Selling of real assets • Migration • Borrowing from neighbours • Intra-community transfers/charity • Sending children to work • Dissaving in human capital	• Selling of financial assets • Borrowing from banks	• Transfers/social assistance • Subsidies • Public works

Source: Prepared by the World Bank (2001, table 2.2, p. 15).

V

The financing challenge

As a variety of studies have shown, there is an urgent need for the countries of the region to initiate or extend, as the case may be, reforms to social protection systems in different spheres: protection against risks associated with greater insecurity of employment; wider coverage for pension systems; measures to deal with the difficulties encountered by the State in meeting its fiscal responsibility for minimum, basic or social security pensions; risk management in pension funds during financial crises, and management of the funds themselves; improving the poor coverage, efficiency and equity of programmes to address unemployment; and increasing medical coverage and the quality of provision. Again, if competition is promoted in medical insurance and provision, regulatory capabilities need to be strengthened in relation to risk selection, cross-subsidies from the public sector to the private sector, bloated financial and insurance intermediation, and high transaction costs when functional separation has been carried out to create quasi-markets.

In terms of social risk, the great heterogeneity of the labour market and the enormous size of the informal sector place special demands on social policy, while restricting the tax base for social policy financing from compulsory contributions or the fiscal budget.

This being the case, there is a crucial role for policies that seek to reduce any trade-offs in financing, for example as regards the contributions of different income groups, or policies that deal with intertemporal trade-offs in financing provided by the State. As we shall now see, financing mechanisms act on these with different objectives in view.[17]

As has already been seen, social financing and risk diversification are essential for dealing with the complexity of insurance markets. As in some pension systems that combine different forms of contribution known as “pillars”, furthermore, compulsory individual contributions should be conditional on a social contribution, and consideration can be given to optional individual contributions designed to retain higher-income sectors, reduce evasion and avoidance and encourage voluntary saving by income strata that are above the taxation ceiling for compulsory contributions.

Postponing reforms that involve higher spending is an option that entails an evaluation of present spending in relation to future spending and that expresses intertemporal options influenced, naturally, by the time horizon of governments and the alternation in power of political groupings. Putting off social investment now because of fiscal constraints may actually lead to considerably greater pressure on public spending in future.

Consideration should be given, for example, to those whose low incomes mean they will have to receive pensions financed out of general taxation when they retire. Given the dynamic of the situation and the continuing deterioration in employment quality, it may be supposed that this contingent is growing all the time. There is scope, however, for action now to bring those excluded from the formal labour market into the contributory system, to minimize the negative impact of labour market dynamics on non-contributory financing. From the conceptual and political point of view, it is worth inquiring into the cost of subsidizing the contributions of sectors whose saving capacity is insufficient to meet the combined contributions payable by the employer and the worker, or by the worker alone if there is no employer’s contribution; in this case, an informal worker’s contribution should be set at a level that does not create spurious incentives for membership of a subsidized regime.

The cost of this subsidy should be weighed against the projected future fiscal cost of non-contributory pensions in the absence of this subsidy to the contributory regime. Consideration also needs to be given to the potential benefits of increased public saving and recognition in the present of what would be a postponed contingency. Again, there is the question of how the subsidy should be financed, whether from specific taxes or a given increase in the tax burden.

Any policy option needs to consider that there is not just one way for the poor to save. For example, there is a range of options involving collective insurance, in which workers’ organizations sign agreements with an insurer that guarantees them a redistributive system, risk diversification and lower transaction and administration costs. The organization then pays an average subscription per person to an insurer and risk diversification takes place in association with a particular cover. The ratio between the average subscription and the individual subscription determines the subsidy, but there is no subsidy for the group as a whole.

As for universality with solidarity-based funding, dismissing this possibility out of hand or analysing solidarity only on an excessively micro scale ignores the historical conditions of our own region, which have allowed countries as dissimilar as Brazil, Colombia and Costa Rica to progress gradually towards this goal.

[17] The remarks on financing that follow are based on discussions with Rebeca Grynspan about ideas formulated by her.

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