

Social Protection and Asset Accumulation by the Middle Class and the Poor in Latin America

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I. Introduction

Globalization, new technologies and the market economy offer new opportunities but at the same time have introduced new risks and vulnerabilities. These risks and vulnerabilities tend to affect more seriously the poor and the middle class that typically have fewer assets and incomes than the rich to protect themselves against unexpected events, economic crises, health crises, natural disasters and other man-made or nature-made calamities. All this has led to an increased demand for “social protection”, a term carrying a slightly paternalistic flavor as it implicitly assumes that the state or special agencies will be entitled to protect vulnerable citizens. Of course a deeper question is to what extent our focus should be on how to design and reform economic system that generate, endogenously, excessive risks and volatility besides looking for palliatives such as social protection

Anti-poverty/social protection policies in Latin America during the (neo) liberal era have largely failed to reduce poverty levels; in fact, above 40 percent of the population was considered to be poor around 2003-04, say over 200 million people. Although poverty has been a chronic problem in Latin America, we can identify various causes why current policies have failed to reduce poverty. These causes often go beyond specific social programs and are linked to the macro and developmental performance of the economies such as: (i) lack of steady economic growth; in the last 15 years. GDP growth in Latin America has not exceeded 3 per cent per year (with lower GDP per capita gains); (ii) in addition to a relatively modest rate of *average* economic growth, this process has been accompanied by a *high frequency of growth crises* in various countries (see Solimano, 2006). These growth crises often lead to cuts in employment and real wages affecting more the poor, (iii) persistent inequality that has reduced the impact of growth (albeit low and unstable) on poverty. Social policies have tried to mitigate these macro and structural developments. However, the practice of “targeting” in the delivery of social goods and services has faced some unanticipated problems as its information requirements were often underestimated. In addition, some of these policies also created new exclusions of those individuals not receiving transfers because although being relatively poor they are not “very poor” as to qualify for

benefits. Moreover, targeted social policies affect the middle class that pays taxes but do not fully receive the social benefits whose taxes contribute to finance.

The role of assets in social policy has been a largely neglected topic in Latin America although a few scholars such as Moser (2006) have emphasized the importance of different assets for anti-poverty programs and to reduce vulnerability of low income groups. From another perspective, De Soto (2000) has shown the adverse effects for saving and capital mobilization stemming from the fact that a vast amount of wealth held by the poor in developing countries is untitled becoming de facto equivalent to “dead capital”.

This paper highlights the role that asset accumulation by the middle class and the poor can play in fostering economic autonomy, reduce vulnerability and improve wealth distribution in economies subject to various sources of volatility. The paper identifies differences as well as complementarities between social protection policies and asset building mechanisms, and identifies some priority areas for new policies that protect growth, strengthen the middle class, and promote asset building.

II. Social Protection and Asset Accumulation: Evolution, Complementarities and Differences

Early Policies of Social Protection

Although the use of the term “social protection” is relatively new, a main concern of social policies in Latin America have been to protect citizens from the adverse effects of unemployment, economic crises, health problems and aging (see ECLAC, 2006). The specific modalities of social policies have evolved according to the broader development strategies adopted by the region and the demands from different social groups for redistribution and social protection. Under the development strategy of import substitution, in place from the 1930s to the 1980s, the main objectives of social policy were social modernization and the formation of human resources needed by the industrialization process. These policies included the expansion of education at various levels, including higher education (universities), housing policies to cope with the home needs of a growing urban population, national public health systems and pay-as-you-go social security. Labor market policies involved legislation on minimum wages, severance payments and restrictions to firing and hiring by firms to ensure job stability of (incumbent) workers. Land reform was also implemented to correct a highly concentrated pattern of land tenure that characterized most Latin American countries. The social constituency behind these policies was labor unions, various organizations in the public and private sectors and rural workers.

This development strategy cum-social policy delivered respectable growth (for today standards) until the late 1970s and a degree of social modernization. However, the economic model of import substitution also involved micro-inefficiencies associated with high import tariffs and the growth of the public sector. The debt crisis of the early 1980s and its legacy of inflation, fiscal deficits, exchange rate instability and debt servicing problems led to a crisis of that development model in Latin America. The criticism of the old economic model was also extended to its social protection model. Main critical elements of the latter were: (i) social spending was not necessarily reaching the most needy in urban and rural areas; (ii) the subsidy of certain basic goods like foodstuff and other goods was fiscally expensive; (iii) public universities, often tuition free, implicitly subsidized the children of rich households and the upper middle class; (iv) the social security system based on pay-as-you go delivered low pensions and failed to contribute to the development of domestic capital markets.

Social Protection Mark I: the 1990s

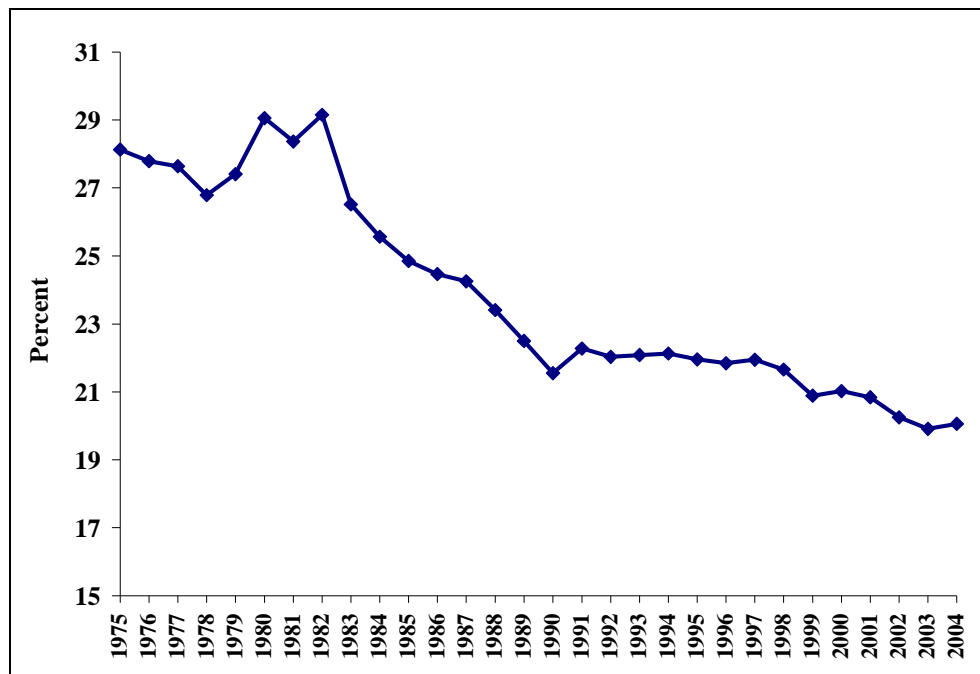
The economic reforms of the 1990s in Latin America included macroeconomic stabilization, external opening, financial liberalization, privatization and market-deregulation (Chile implemented similar policies earlier in the mid 1970s under the Pinochet regime). These policies were oriented to expand the possibilities of wealth creation through private sector activity and the use of markets and international trade in goods and financial assets. However, the application of these policies had social costs and the new policy regime open to markets brought new forms of economic instability and risks that needed to be mitigated. The social (protection) policies in the 1990s had the following main features:

- (i) The main social objective was poverty reduction led by faster economic growth following the adoption of market-based reforms. The main variable to be protected was *income*, defined as the level above or below a certain poverty line. Clearly the definition focuses on the *flows* rather than on the *stocks –or assets*. In fact, the reduction of wealth and income inequality was not an explicit policy priority for these policies (see Solimano, 1998). This is in contrast with several experiments, of varied degree of success or failure, of income and wealth redistribution in the 1960s, 1970s and 1980s in the regionⁱⁱ.
- (ii) Social protection policies had to focus on assisting the most vulnerable segments of the population (the poor, the elderly, children, the handicapped). This was the principle of “targeting”. The intuitive idea of reaching the neediest is appealing both from the viewpoint of simple common sense as well from a more instrumental logic of helping to minimize fiscal

- costs and help macroeconomic stabilization. Nevertheless targeting is not free of problems as its informational and operational requirements are not minor.
- (iii) Targeting has to be complemented by social emergency funds oriented to provide support income and public works programs to low-income groups in the wake of severe macro-economic crises or natural disasters.
 - (iv) Promotion of private sector participation in the delivery of education, health and pensions as a natural corollary of private sector-led development.
 - (v) Labor markets policies were oriented to ensure more labor “flexibility” by relaxing firing rules reduce severance payments; minimum wages were de-emphasized as an income support policy.

A full evaluation of the results of these economic and social policies is beyond the scope of this paper. However, the results of social and development policies, for the region as a whole, are not encouraging in terms of rapid and sustained growth, poverty reduction and lower inequality. As a consequence of modest growth Latin America’s GDP per capita as share of the GDP per capita of more advanced countries (i.e. the US) was stagnant and/or declining in the last 10-15 years (see figure 1).

Figure 1. Latin America and the Caribbean GDP per capita (PPP) as a percentage of the United States GDP per capita (PPP), 1975-2004
(Percent)



Source: Own elaboration based on figures from World Bank Indicators (WDI).

In addition, modest average growth has been accompanied by *volatility and growth crises* that took place during the last two decades (see Solimano, 2006). Needless to say those with fewer assets and lower incomes tend to suffer more in downturns and crises that destroy jobs and increase poverty.

Table 1. Growth Crisis in Latin America and Reference Group, 1960-2003

	Number of years with negative GDP per capita growth rates			Percentage of crisis in total period
	1960-1980	1981-2003	1960-2003	1960-2003
Argentina	6	11	17	38.6
Bolivia	4	9	13	29.5
Brazil	2	11	13	29.5
Chile	4	3	7	15.9
Colombia	2	5	7	15.9
Costa Rica	3	8	11	25.0
Dominican Republic	4	6	10	22.7
Ecuador	3	8	11	25.0
Mexico	0	8	8	18.2
Peru	4	10	14	31.8
Uruguay	5	9	14	31.8
Venezuela	10	13	23	52.3
<i>Average</i>	<i>3.9</i>	<i>8.4</i>	<i>12.3</i>	<i>28.0</i>
Korea	2	1	3	6.8
Thiland	0	2	2	4.5
Philippines	0	7	7	15.9
Ireland	2	2	4	9.1
Spain	2	2	4	9.1
Turkey	5	6	11	25.0
<i>Average</i>	<i>1.8</i>	<i>3.3</i>	<i>5.2</i>	<i>11.7</i>

Source: Solimano (2006).

Casual evidence suggests unequal access to education and health services by low-income groups and the middle class compared to the upper middle class and the wealthy. The reality in Latin America today is that in several countries the private systems of delivery of social services offer better quality education and health services (although probably below the standards of advanced countries) to the upper middle class but the poor and the lower middle class can not afford paying for private provision unless they receive a subsidy. Most of the time people attend insufficiently funded public education and public health systems. The quality of education is segmented geographically and by income levels (better education is often found in urban than rural areas and in more affluent neighborhoods than in poor ones). Moreover, international test of educational performance in Latin American countries often show significant differences between private and public schools.

In the health sector, public hospitals are often under-funded and queuing time for patients is routine. In Chile, in recent years, thousands of families have left the private health - insurance system of ISAPRES and switched to the state run FONASA system (Fondo Nacional de Salud) because of the escalation of costs in the private system and the limited coverage of the services offered (Solimano and Pollack, 2006).

Asset Accumulation and Social Protection: Complementarities and Differences

The asset accumulation approach (see Moser, 2006) identifies various assets that affect the well-being of individuals and communities such as material assets (land, capital, housing), financial assets, social capital (the network of contacts, norms, culture among individuals in a certain community), natural capital and others. The approach goes beyond a purely economic approach to the issue of asset formation and focuses also on the role of mechanisms of social interaction and social support in helping people to cope with adverse circumstances.

From an economic perspective assets (under certain conditions) can provide protection against unexpected shocks, helping to reduce vulnerabilities. If a person suffers a temporary loss of income an asset can provide collateral to borrow to maintain consumption. In the event that the loss of income is of a more permanent nature, a person (or household) can sell the asset although this will reduce his net worth. Assets must have an economic value, be traded in certain markets and be potentially *liquid* to be accepted as collateral for borrowing or to find a buyer in the case of selling the asset. In addition, property rights on the asset must be clearly defined. Not all assets comply with these conditions. Non-economic assets such as social capital have a different value to a liquid economic asset. Still, social capital can help cushion negative shocks by providing other non-market mechanisms such as social interaction and community groups.

Social protection policies can operate through the assets side and/or through the flows. If a pension system is based on the individual accumulation of assets as in a privatized system then individual assets are a cushion against the decline in income associated with ageing. If social protection is based on the provision of temporary income or jobs to the unemployed it will operate more on the flows side and will rely on the decision of government to provide that protection. In a way, individual assets is closer to *self-insurance* whereas social protection is a form of *social insurance*. Social capital is based on “civil society” organizations rather than on the direct intervention of the state.

The empirical relevance of the asset approach will depend on the pattern of ownership of assets: what type of assets hold the middle class and the poor, their liquidity and the structure of property rights. These issues are taken up in the following sections.

III. Asset Distribution in Latin America.

Income distribution is (and has historically beenⁱⁱⁱ) quite unequal in Latin America: cross country average Gini coefficients, a measure of income concentration, are around 0.5 well above OECD and East Asian levels. A recent study of patterns of asset ownership in Latin America is Torche and Spilerman, (2006) whose main results can be summarized as follows:

- (i) Housing is the most widespread asset held by households in the Latin America region. For the vast majority of the population this is the only asset held in their portfolios. A large proportion of the population, (69 percent) owns their homes in Latin America. This proportion of home-ownership is similar to the United States and is relatively uniform across various socio-economic levels in Latin America.
- (ii) This high pattern of home ownership in Latin America is associated with housing policy for the poor and the middle class and also with (illegal) settlement of public land in cities historically carried-out by movements of *pobladores*.
- (iii) Education is another “asset” although of different characteristics than material assets such as housing, land and financial assets as it is embedded in people and therefore far less liquid than these other assets. Education has expanded at all levels (primary, secondary and tertiary). In contrast, to the more extended access to “quantity education” we have considerably more social differentiation in the access to “quality education”.
- (iv) Land concentration has been historically high in Latin America although agrarian reforms in various countries led to a decline in land concentration. The growing urbanization of the region has diminished the importance of land inequality.
- (v) Capital assets such as business assets, rental property, stocks and bonds are much more concentrated than home equity. The highest income percentiles concentrate the ownership of financial and capital assets in Latin America.

Thus we observe that asset distribution is not uniform across different types of assets with a clear differentiation between financial and capital assets and housing (more egalitarian the distribution of the

latter). In addition, a feature of some countries in Latin America is the absence of formal titling for resources and property owned by the popular classes. The typical case is the lack of land titling in urban dwellings a fact that impedes the use of these assets as collateral for obtaining loans by the banking system (see De Soto, 1989, 2000). Incomplete property rights are then considered to be a cause of the limited access to capital accumulation by the poor as it was mentioned before.

Segmentation in the access to credit and high quality education by socio-economic status is one factor that prevents a more egalitarian distribution of assets. Also variables such as family background (income, wealth, education level of the parents, occupational status, social connections, etc.) are powerful factors that tend to reproduce across generations the inequality in wealth, access to political power and influence in society.

IV. Building Blocks for Better Policies: Growth, the Middle Class and Asset Accumulation.

New and more balanced social protection and development policies for Latin America should recognize broader goals and more instruments. We can identify at least three areas in which development policies can be broadened to include, among other things, asset accumulation by the poor and the middle class (see also ECLAC 2006 for specific proposals in the areas of pensions, health systems and other policies of social protection):

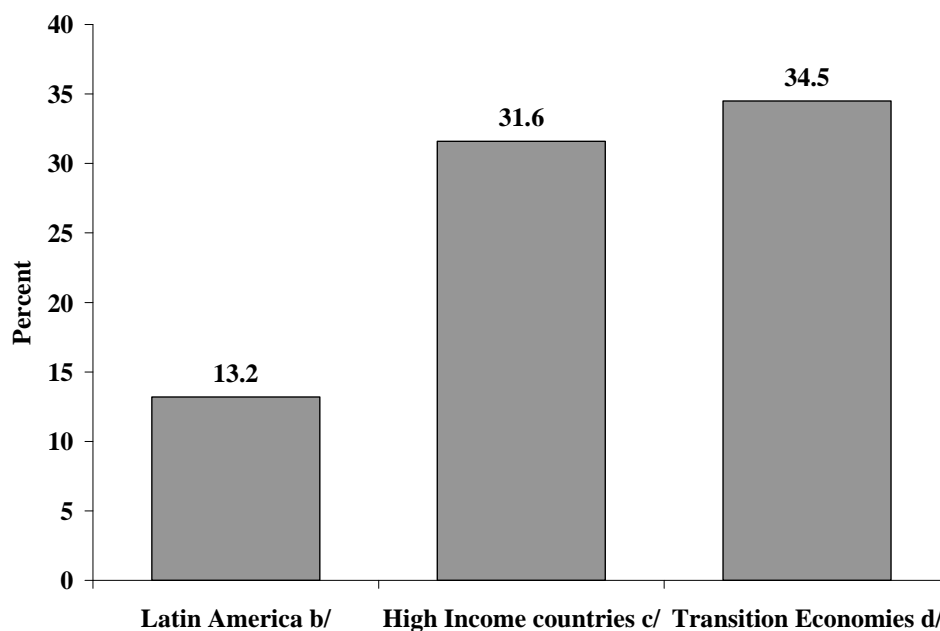
Stability and growth

The main macro accomplishments of the 1990s and early 2000s in Latin America have been the reduction and stabilization of inflation, the improvement of fiscal budget and a stronger external sector position. This is important for the poor as inflation affects them more severely than other groups. In addition, macro stability creates conditions for more sustained growth if the growth impulse is there. Unfortunately, except in the early 1990s with the resumption of capital flows and the launching of reforms and in the 2004-2006 with commodity price booms, sustained and high growth has been elusive in most of Latin America when considered in a medium-term perspective. The lack of sustained growth and its volatility has impeded, as mentioned before, the improvement of social conditions in the region in a sustained way. Growth helps create jobs, boost wages and provide fiscal revenues for the government that can be spend in (good) social policies. It is hard to think of lasting solutions for social problems without some basic stability and steady economic growth. In recent years the main gains in poverty reduction in Latin America (i.e. the case of Chile) and elsewhere (i.e. China) have taken place in countries that experienced rapid GDP growth. Of course, growth is not the whole story and policies to strengthen the middle class, reducing inequality and widening the access to productive assets and social capital are also very important.

The Middle Class and Lower Inequality.

Latin America is a continent of large inequalities as income is concentrated at the top. As a consequence of this *mean income* is often greater than *median income*, a feature typical of concentrated income distributions. The size of the middle class measured as both share of total income and total population is often *smaller* in America Latina than in OECD and former socialist countries of Eastern Europe (see Birdsall, Graham and Pettinato, 2000, and figure 2)^{iv}. The smaller size of the middle class is related to the fact that income is concentrated..

**Figure 2. Size of the Middle Class a/
(Middle Class's income share)**



Notes:

a/ The "Middle Class" is composed by those households with per capita income between 75% and 125% of the median income.

b/ Latin America includes: Brazil, Chile, Costa Rica, Mexico, Panama, and Peru.

c/ High Income countries includes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Luxembourg, Netherlands, Spain, Sweden, Switzerland, Taiwan, United Kingdom, and United States.

d/ Transition Economies includes: Czech Republic, Hungary, Poland, Russian Fed., Slovak Republic.

Source: Birdsall, Graham and Pettinato (2000). Data corresponds to the 1990s.

Stable, higher income democracies often have a strong middle class and relatively low levels of inequality. In contrast, polarized, lower to medium income per capita countries often have a weak middle class and concentrated income distributions.. The political correlate of this system is often volatile and populist politics (see Solimano, 2005). A stronger and more stable middle class is often considered as a stabilizing factor in politics and economics as in the later case private investment is very sensitive to instability and political polarization. More universal social policies can strengthen social cohesion and stabilize politics, thereby favoring social peace and economic growth. Easterly (2000) has shown, based on cross country and panel econometric regressions, that a higher share of income for the middle class (and lower ethnic polarization) are empirically associated with higher income, higher growth, more education and other favorable development outcomes.

Part of the story of building a stronger middle class is providing people a better access to assets such as housing and education, the two main assets that the population accumulates. In addition, the middle class is the owner of small and middle enterprises that are often in need to finance capital investment and working capital. Moreover, as their savings capacity grows over time they need access to financial assets to build their portfolios.

Democratizing Asset Accumulation.

A broader access to asset accumulation by the poor and the middle class can contribute to mobilize their hidden productive potential with positive effects on economic efficiency, growth and social welfare. Moreover, a stronger asset position helps protecting against negative shocks. There are three main impediments for a more evenly distribution of assets in the Latin American region. These impediments can be removed, however. One is the limited savings capacity of low income groups (although their savings capacity is not zero as hinted before). Usually low income families can save to finance the down-payment of a house or other type of property. In addition, in most countries they have a certain economic capacity to acquire durable goods. During the process of economic development, the relationship between savings rates and the levels of per capita income is non-linear and relatively large increases in savings can take place after growth takes off at low to intermediate levels of per capita income. Second, as mentioned before for assets to be able to mobilize capital, property rights must be well-defined and enforceable. In Latin America low income groups have acquired their main asset (housing) often through non-market mechanisms: occupation of urban dwellings and/or subsidized housing policies. Some house owners have titles on their property while others do not. The legal system unfortunately, is expensive and often unfriendly to the poor. In fact, the design and enforcement of contracts is costly, and it requires some legal education and access to lawyers. The poor often can not afford all that. Third, capital markets are also segmented serving better the elites than the poor and the middle class. The traditional circuits to accumulate material assets and also to acquire higher education such as borrowing and access to capital markets have been largely restricted to the non-poor (the elite hold assets that can be used as collaterals and/or have the right connections to access to credit and get their children in good quality schools).^v The reform of judiciary systems to make the access of justice more expedite to the poor is essential if we want to make asset accumulation a more egalitarian process.

V. Concluding Remarks.

This paper has reviewed the conceptual underpinnings of social protection policies in Latin America implemented under various policy regimes including import substitution policies, market oriented reforms of the Washington Consensus and hybrid regimes. The paper highlights the need to go beyond policies based purely on growth-based, poverty reduction and targeted social policies to bring the middle class into the picture and exploit the potential of asset building to cope with adverse shocks, boost savings, investment and promote upward social mobility.

The literature on assets building identifies a wide range of assets ranging from material assets such as housing, land, financial assets to social and communal assets. Economists stress the role of assets in coping with negative shocks. However for assets to be economically valuable for that purpose the property rights must be reasonably well-defined and the assets must have liquidity. Other social scientists emphasize the role of social interactions, family and community relationships –social capital-- as mechanisms of social protection. In reality individual assets and social capital can complement to provide social protection and enhance social progress.

In the paper we show that in the last two decade or so modest and unstable growth, persistent inequality and narrowly defined social policies have hampered more rapid social progress in Latin America. The paper stresses the importance of stability and growth as a framework for poverty reduction and broad social improvement, but also underline the need to reduce inequality and strengthen the middle class and widen the access to assets by the poor and the middle class. A more widespread and less unequal ownership of assets in society can have a *growth dividend* by unleashing creativity, entrepreneurship and innovation latent in groups that traditionally have little access to formal capital markets and the legal system. More egalitarian asset accumulation could be expected to have also a political dividend for democratizing the traditionally elitist Latin American societies.

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ⁱⁱ The cases of Cuba in the early 1960s, Chile under Allende in the early 1970s, Nicaragua in the 1980s under the Sandinistas were the most radicalized experiments of redistribution. More gradual policies with a redistributive bend were implemented in Costa Rica and Uruguay among others.

ⁱⁱⁱ Historically Latin America has had a quite unequal pattern of wealth distribution linked to concentrated land tenure and a social structure of relatively limited social mobility.

^{iv} Birdsall et.al (2000) define the middle class as the group whose income are in the range of 75 % and 125 % of the median income in a given country.

^v Stable, higher income democracies often have a strong middle class and relatively low levels of inequality. In contrast, polarized, lower income countries often have weak middle class and concentrated income distributions.