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### **Paper for Session 7: Regulation, Competition and the Poor**

#### **Regulation and Social Protection**

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## Regulation and social protection

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### *Abstract*

The paper considers the implications for regulation of the emergence of social protection as the main paradigm of social policy in developing countries. It introduces and examines the main features of social protection and the factors behind its adoption. It considers the implications of some specific instruments of social protection for regulation. It then moves on to consider links between social protection and other regulatory domains, and the feasibility of identifying regulation regimes. The paper argues for greater attention to be paid to the role of social protection within regulatory regimes.

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There is an emerging consensus among multilateral institutions around the need for developing countries to strengthen and develop social protection policies and programmes as an urgent response to economic crisis and rising vulnerability (IADB 2000; Asian Development Bank 2001; ILO 2001; World Bank 2001).<sup>1</sup> Social protection covers a wider range of programmes, stakeholders, and instruments than alternatives such as, ‘social security’, ‘social insurance’, or ‘safety nets’. The interest in social protection is a consequence of globalisation trends which increase risk and vulnerability and therefore the demand for social protection, while at the same time restrict the capacity of governments to respond to this demand (Rodrick 1997; Alesina 1999; Tanzi 2000). Social protection is therefore emerging as paradigm of social policy in developing countries.

The emergence of social protection as the new agenda of social policy has important implications for regulation of enterprises and markets. Regulation is here understood as rules, norms, and institutions, aimed at achieving stated public policy goals. The emerging social protection agenda gives regulation a very significant role in reducing social risk and vulnerability. It encourages the reform and extension of existing regulation, and the development of new forms of regulation in developing countries. It includes the extension of labour standards and the regulation of the employment relationship as an important instrument in preventing and mitigating employment related income risk. It also includes the development of environmental and health and safety regulations as a means of preventing health risks, which materialisation may adversely affect consumers and employees. It includes mandated employee insurance covering health expenditures, work related injuries and disability, and old age and dependant pensions. Another important development includes access and prudential regulations applying to financial institutions and other private social protection providers. Self-regulation in the form of codes of conduct or sectoral agreements binding participating firms to risk-sensitive behaviour, provides another important instrument of social protection. As is apparent from this list, regulation and self-regulation of enterprises and markets constitute important components of social protection, and the adoption of social protection will involve a significant extension and development of regulation in developing countries.

It is an interesting question whether the predicted changes in regulation encouraged by social protection will have any effect on the regulatory environment in developing countries. Regulation arising from social protection policies is perhaps a small subset of the overall regulation applying to enterprises and markets, but a handful of studies focusing on links between regulatory domains suggest social protection regulation can have important implications for other forms of regulation. Studies on advanced economies have shown a relationship existing between the openness of an economy and the development of social insurance, redistribution, and wage compression norms (Atkinson 1997; Agell 1999; Atkinson 1999; Agell 2000). If this applies to developing countries as well, extensive trade liberalisation should impact upon social protection and other regulatory domains. A study on the relationship existing between product market regulation and employment protection for OECD countries finds that countries having tight product market regulation also have strong employment protection policies (Nicoletti, Scarpeta et al. 2000). These suggest there are interesting implications for regulatory reform which need to be explored in a developing country setting. Changes in the regulations applying

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<sup>1</sup> The World Bank’s Social Protection Sector Strategy paper argues there are important similarities between social protection and the sustainable livelihoods approach of the UNDP and DFID (World Bank 2001).

to trade and finance, and those applying to product markets, are likely to have an impact on social protection regulation, and vice versa. Furthermore, to the extent that regulatory regimes can be identified in developing countries, social protection may have implications for these as well.

These are the issues addressed in this paper. The approach in the paper is exploratory and speculative. The aim is to explore the interactions existing between social protection and regulation with a view to identify key issues and trends, and a methodology for analysing them. For pragmatic reasons, the empirical backdrop to the paper is restricted to countries in Latin America and the Caribbean, and OECD countries for comparison. It is intended that the analysis will be extended to other developing regions, where different priorities and circumstances may well apply. The paper is organised as follows. Section One discusses the main features and distinctiveness of social protection, and provides a brief review of the main factors behind its emergence as a social policy paradigm. Section Two discusses the implications of social protection for regulation, focusing on recent developments in the extension of labour standards, mandated employee insurance, and the increasing role of private social protection providers. Section Three discusses the implications of social protection for other regulatory domains, and argues for the need to identify and evaluate regulatory regimes. It briefly, and simplistically, considers these issues empirically in the context of Latin America. A final section concludes.

### *I. What is social protection?*

Social protection has traditionally been defined in terms of a range of public institutions, norms and programmes aimed at protecting individuals and their households from poverty and deprivation. These broadly include labour and employment standards, programmes aimed at covering contingencies arising from life-cycle contingencies such as maternity and old age, norms and programmes directed at work related contingencies such as unemployment or work related injuries, and basic safety nets. Social protection is generally taken to be broader than social security, which is normally associated with compensatory, comprehensive, welfare state programmes existing in advanced economies.<sup>2</sup> Social protection is also broader than social insurance, normally restricted to contributory programmes covering a specific range of contingencies. It is broader than social safety nets, which are mainly short-term interventions in response to food or income crises. In its traditional meaning, therefore, social protection is a broader and more diffused concept.

In the 1990s, the concept of social protection underwent a significant transformation. Within the context of economic crises, structural adjustment, and globalisation, social protection has been increasingly adopted as the paradigm defining an agenda for social policy in developing countries.<sup>3</sup> Social protection is now defined as consisting of “public actions taken in response to levels of vulnerability, risk, and deprivation which are deemed socially unacceptable within a given polity or society” (Conway, de Haan et al. 2000). There is an emerging consensus around

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<sup>2</sup> In the ILO’s perspective, for example, social security is restricted to ‘statutory schemes’.

<sup>3</sup> For a discussion of the transformation of social protection within the World Bank, see World Bank (2001), and for a restatement of social protection within the ILO see ILO (2001).

the view that social protection can provide a more appropriate framework for addressing rising poverty, vulnerability, and inequality in the context of current conditions in developing countries.

There are important nuances in the definition of the scope and emphasis of social protection, especially among multilateral agencies, and the best way of characterising social protection is to note its most distinctive strands:

1. Social protection focuses poverty reduction and on providing support to the poorest (de Haan 2000). This is different to the focus of social security, which includes redistribution, and social insurance on contingencies.
2. Social protection seeks to address the causes of poverty, and not simply its symptoms (World Bank 2001). It is postulated that the causes of poverty are to be found in the multiple social risks faced by the poor, and in their vulnerability to the impact of these risks. The realisation of social risks affects the welfare of the poor directly, but their greater vulnerability to risks leads to risk averse behaviour by the poor which is also detrimental to their welfare. It can be argued that by focusing on social risks, social protection addresses the dynamic nature of poverty (de Haan 2000).
3. The focus on risk and vulnerability as the main cause of poverty also implies that social protection is 'forward looking' in underlining the need to develop interventions to reduce risk and vulnerability. Public interventions are evaluated as investments rather than costs (World Bank 2001), and seek to develop the capacity of the poor to reduce, ameliorate, or cope with social risk. Social protection draws particular attention to human capital investment, and more generally to productive investment as key to poverty reduction.
4. Social protection acknowledges the variety and heterogeneity of risks affecting individuals, households and communities, and therefore acknowledges the multidimensional nature of poverty (Lund and Srinivas 2000). Employment and labour market risks are acknowledged to be significant, and interrelated with other sources of risk and vulnerability. Labour market social protection instruments are therefore given a key role.
5. Social protection draws attention to a wide range of stakeholders, programmes and institutions, and instruments, involved in the provision of social protection in developing countries, from formal social insurance programmes, to the universal provision of health and education, to informal social networks, micro-insurance, and intra-household support (Esping-Andersen 1999; Esping-Andersen 2002). It draws attention to the need to 'crowd in' and articulate existing forms of social protection (Murdoch 1998).
6. Social protection acknowledges the importance of a gender dimension to the distribution of risk and vulnerability, and therefore to poverty reduction strategies (ILO 2001, p.39; World Bank 2001, pp.27ff).
7. Social protection addresses the impact of globalisation on the demand and supply of social protection. Globalisation raises the need for social protection because it generates greater risk

and uncertainty particularly among the poor (Rodrick 1997). At the same time, globalisation can lead to a reduction in the tax base of developing countries, further diminishing the already limited provision of public social protection (Tanzi 2000). While acknowledging the important role of public provision of social protection, and the important role of governments in supporting and strengthening other forms of provision, the articulation of a broader set of providers and instruments, including private, not-for-profits, and household provision, is taken to constitute a necessary response to globalisation.

8. Social protection highlights issues of governance and participation in the design, financing, and provision of social protection (World Bank 2001).

These strands of social protection amount to a very comprehensive, as well as effective and timely, statement regarding a social policy agenda in developing countries. They also reflect a significant shift in perspective, and an emerging consensus, among the multilateral agencies in the field.

There are important nuances in the definition of social protection used by different donor agencies reflecting their specific outlook. The Social Protection Strategy Paper from the World Bank, for example, moves beyond ‘traditional’ social protection in defining a ‘social risk management’ framework adding macroeconomic stability and financial market development to typical social protection programmes. Social risk management (SRM) consists of public interventions “to assist individuals, households and communities in better managing income risks” (Holzmann and Jorgensen 1999, p.4). It is this approach that we refer to as ‘transformed’ social protection in this paper. The emphasis on agency and income protection is in line with the Bank’s broader approach to development. The ILO, on the other hand, sees social protection as arising from basic rights.<sup>4</sup> It is defined by “entitlement to benefits that society provides to individuals and households – through public and collective measures – to protect against low or declining living standards arising out of a number of basic risks and needs” (von Ginneken 2000). The emphasis on rights is also in line with the ILO’s basic approach.

There are also differences in emphasis dictated by the particular circumstances and priorities of different agencies. The Asian Development Bank defines social protection as “the set of policies and programs designed to reduce poverty and vulnerability by promoting efficient labor markets, diminishing people’s exposure to risks, and enhancing their capacity to protect themselves against hazards an interruption/loss of income” (Asian Development Bank 2001, p.1). The Inter-American bank, on the other hand, states that social protection consists “of the set of public initiatives that can lessen the impact of adverse shocks on the income of the population”, including inter alia “public actions aimed at reducing risk such as prudent fiscal policy to prevent macroeconomic crises” (Lustig 2001, p.1). The differences in emphasis reflect the strength of growth in Asian economies, and the presence of recurrent economic crises in Latin America.

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<sup>4</sup> In the more recent *Social Security. A new consensus*, a painstaking effort is made to broaden the organisation’s emphasis on social security in the direction of social protection by drawing a parallel existing between the latter and the ‘decent work for all strategy’. As noted in this document, one “of the essential features of the decent work approach is that everybody is entitled to basic social protection” (ILO 2001, p.39). This is taken to be an extension of the 1948 Universal Declaration of Human Rights’s article 22 stating that “everyone, as a member of society, has the right to social security...”, via the 1966 International Covenant on Economic, Social and Cultural Rights’s article 9 stating “the right of everyone to social security, including social insurance” (ILO 2001).

A number of factors explain the rise of social protection as a dominant agenda for social policy, but the effects of globalisation, trade and finance and labour market reforms are the most important. Globalisation has been a significant factor in the emergence of social protection. The greater openness of developing economies implies a greater vulnerability to changes in global markets, and a greater concentration of social risks on the less powerful participants. Within developing countries, social risks are also concentrated on the more vulnerable sectors. Globalisation therefore raises the demand for social protection (Rodrick 1997). At the same time, globalisation reduces the tax base of national governments, for example through the migration of high skilled workers, the restrictions on taxes brought about by the need to remain competitive in international markets, and the growth in internet commerce (Tanzi 2000). In reducing the tax base, globalisation undermines the capacity of governments, especially in developing countries, to meet the greater demand for social protection. An important implication arising from this is that effective social protection cannot rely solely on public expenditure and on direct public provision, although governments retain a central role in the production of social protection. A wider set of providers, instruments, and programmes is needed to meet the increased demand for social protection, and this is an important factor behind the social protection paradigm.

## *II. The implications of social protection for the regulation of enterprises and markets*

The emerging social protection paradigm gives regulation a key role in preventing and mitigating social risk and vulnerability, by encouraging the reform and extension of existing regulation, and by encouraging new forms of regulation. This section focuses on new forms of regulation arising from social protection by examining three important new areas of regulation: insurance mandates, the regulation of private insurance providers, and self-regulation in global networks. Social protection will have wider effects upon regulation, but these three areas provide distinctive examples.

### *Mandated individual saving plans*

Economic crises and restructuring have placed strong pressure on government finances, both through a reduction of the tax base and through pressure to reduce fiscal deficits. Where governments are responsible for social security programmes, covering pension or health insurance, these pressures have translated into a deterioration of benefit coverage and levels, and growing pressure for reform. In the context of Latin America and transition economies, governments have sought to reform these programmes by transferring responsibility for insuring against old age, unemployment, and health expenditures to workers, and to a lesser extent to their employers, through mandating saving plans. At the same time, governments have encouraged the establishment of private insurance providers (Barrientos 1998, 1999; Barrientos and Lloyd-Sherlock 2000).<sup>5</sup> Mandating saving plans is increasingly replacing direct or indirect public

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<sup>5</sup> Individual retirement saving plans have been introduced in Chile, Argentina, Peru, Colombia, Uruguay, Bolivia, Mexico, El Salvador, Nicaragua and Costa Rica. Individual health insurance saving plans have been introduced in Chile, Argentina, Colombia and Mexico. Individual saving unemployment plans have been introduced in Chile and Colombia. Chile and Colombia are experimenting with demand subsidies for the financing of education, which could be easily complemented by saving plans.

provision, and has become a key instrument in the provision of social protection in Latin America and transition economies (Barrientos 2002). Saving plans have important implications for the regulation of firms as employers, and as providers of social protection.

It is not possible here to provide a full review of the literature on mandated employee benefits. Summers argues that mandating employee benefits has advantages over alternative forms of organising provision, and especially over government direct provision on the one hand, and over bargained benefits on the other (Summers 1989).<sup>6</sup> There is also a growing literature on individual saving plans as an instrument of social protection (World Bank 1994; Barrientos 1998; James 1998; Folster 1999; Barrientos and Lloyd-Sherlock 2000). The key feature of mandated individual saving plans is that the link between contributions and benefits is direct, because redistribution and insurance are minimised. A wedge between contributions and benefits reflects mainly the profile of investment returns attached to the savings.<sup>7</sup> Proponents of individual saving plans argue that these have few disincentives to work and save. An associated reduction in the level of mandated contributions could also encourage labour demand in formal employment.

In Latin America and transition economies, the involvement of employers is normally restricted to ensuring their employees comply with the mandate, collecting their contributions, and depositing these with the provider of choice. Employers are seldom required to make contributions, or to manage saving plans. The costs associated with compliance may differ by firm size, and the extent of managerial specialisation. The regulations associated with mandated insurance may have implications for firm size and sectoral choice (formal-informal). A simple model can illustrate this point (Squire and Suthiwart-Narueput 1997).

Assuming the employer profit function is:

$$\pi(r, w) = \max_{K, L} F(K, L) - wL - rK, \quad (1)$$

where  $\pi$  is profits,  $K$  and  $L$  are capital and labour respectively, and  $w$  and  $r$ , are wages and rate of return to capital respectively. The introduction of a mandated employee pension and health insurance generates for the firm costs  $\tau$  per worker. These costs are most likely decreasing in firm size, so that  $\tau(L) > 0$ ,  $\tau'(L) < 0$ , and  $\tau''(L) > 0$ . The range of possible responses by the firm includes compliance, evasion and avoidance. Avoidance assumes that the mandated coverage is not universal, and that it is possible for the firm to reorganise employee input so as to avoid compliance, but at a transaction cost  $\theta$  per worker, with  $\theta > 0$ . The firm can alternatively choose to evade the mandate, but risks a penalty  $P$  with probability of inspection  $\lambda$ , with  $\lambda > 0$ . The impact of the different responses on the firm's profit function  $\pi^M$  are,

	$\pi^m(r, w) - \tau(L)$	if comply
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<sup>6</sup> See also (Mitchell 1990; Ippolito 1997).

<sup>7</sup> In social insurance funds, such as those common in Latin America and transition economies before the reform, extensive, and in cases perverse, redistribution, and also strong insurance features, were responsible for a significant misalignment of contributions and benefits. Proponents of reform argue this is one of the most important reasons for reform, but see Gruber (1997), and Barrientos (1998).

$$\pi^M(r, w) = \begin{cases} 1 - \pi^M(r, w) + \pi^M(r, w) - P - \pi(L) & \text{if evade} \\ \pi^M(r, w) - \pi L & \text{if avoid} \end{cases} \quad (2)$$

The firm will avoid rather than comply if

$$\pi L > \pi(L) \quad , \quad (3)$$

and the firm will evade rather than comply or avoid if

$$\pi / 1 - \pi \{P + \pi(L)\} > \pi L > \pi(L) \quad . \quad (4)$$

Assuming that avoidance transaction costs per workers are constant, and that fines are independent of firm size, there will be a size of firm for which avoidance will be preferable to evasion. Furthermore, with compliance costs decreasing in firm size, there will be a larger size of firm where compliance will dominate avoidance. The firm's strategy in response to the mandated benefit collection and administration costs can be summarised in

$$\pi = \min \{ \pi / 1 - \pi [P + \pi(L)] , \pi L , \pi(L) \} \quad (5)$$

This simple model demonstrates that the regulations associated with mandating employee insurance could have implications for firms and markets. Whether these are important empirically is a matter for further research.

### *Regulating financial and insurance providers*

The introduction of individual saving plans as a key instrument of social protection creates the conditions for the development of new financial and insurance providers specialising on social protection: pension fund managers, health and unemployment insurance providers, etc. In addition, existing financial intermediaries are encouraged to expand the range of financial instruments associated with these developments, e.g. annuity provision. Regulation of the new providers is important in facilitating the bedding down and success of the reforms (Shah 1997; James, Ferrier et al. 1998; Queisser 1998; Vittas 1998; Barrientos 1999; Yermo 2000; Barrientos and Bousofiane 2001). On paper, the new providers could play a very significant role in opening up financial and insurance markets to vulnerable groups. The success of regulation will therefore have far reaching implications for households' access to credit and insurance, and therefore on their ability to self-protect against social risks.

Regulation of private providers of social protection is needed because of information asymmetries affecting insurance provision. In the absence of product and price regulation, private providers of insurance have an incentive to select low risk, high income groups, and repel high risk low income groups. They also have an incentive to exploit superior information by absorbing the returns to investment in the form of high costs and profits. In the absence of regulation, private insurance providers also have an incentive to take excessive risk with the investment funds in their charge, an instance of moral hazard arising from the commitment of the governments in the alleviation of hardship. Regulation is also needed because of the relative

underdevelopment of financial and insurance markets in developing countries, which sometimes requires a significant injection of competition, and at other times calls for the creation of markets anew. In setting out the regulation of these providers, the challenge is to make insurance markets work for the benefit of the more vulnerable groups in the population.

### *Extending labour standards through supply chains*

The integration of production and distribution networks across the North and the South is a direct consequence of globalisation and a good example of the development of new forms of regulation on social protection. Some authors refer to these networks as 'commodity chains' or 'value chains' (Gereffi and Korzeniewicz 1994; Dicken, Kelly et al. 2001; Gereffi and Kaplinsky 2001). Typically, enterprises located in the North source from the South, involving a network of importers, exporters, and producers. The networks are dominated by Northern enterprises. These are in a position to organise and control the different aspects of production and distribution across the network, without the need to engage in formal ownership. Producers in the South incorporated into these networks are exposed to competition from other producers on a regional or global scale. As a consequence, these global networks concentrate most of the production and exchange risks on the weaker segments of the chain located in the South (Barrientos 2001). At the same time, because these global networks are regulated by Northern firms, these are under pressure to impose environmental and labour standards throughout the network.

Horticultural networks are a good example (Barrientos, Kritzinger et al. forthcoming). Supermarkets in the North source their fruit and vegetable from producers in the South, involving an array of exporters in the South and importers in the North. The technical demands on the coordination of the network are high, involving a significant investment from all those participating in the network. The producers in the South are exposed to strong competition from other domestic producers, and from producers in other countries. Their vulnerability to production and exchange risks is usually passed on to the workforce employed overwhelmingly on a temporary and informal basis (Barrientos 2001). Northern supermarkets are increasingly adopting environmental and labour standards and enforcing these on the producers in the South. These voluntary codes of conduct constitute a form of self-regulation with a significant potential to provide a basic measure of social protection for these workers (Barrientos and Ware Barrientos 2002). In a European context, self-regulation has crystallised in the Ethical Trade Initiative, grouping many of the participants in the global networks, supermarkets, trade unions, and NGOs, and seeking to develop and standardise codes of conduct and establish mechanisms for monitoring and enforcement.

The impact of these codes of conduct on the regulatory structure and conditions in developing countries is currently under investigation. The introduction of labour standards for a largely informal and highly vulnerable workforce in the agricultural sector in developing countries could lead to their extension to other sectors. Alternatively, the impact of their introduction on local labour markets may help to reinforce the unprotected nature of employment in agriculture, especially if local producers unable to integrate into global networks are forced to impose lower pay and working. An important point is that codes of conduct provide a different route to the extension of labour standards in the South.

### *III. Social protection, links between regulatory domains, and regulatory regimes*

The previous section considered specific areas where the adoption of social protection will have implications for regulation. In this section, the focus is the regulatory regime as a whole. This section considers whether social protection is likely to have implications for other regulatory domains, and for the overall regulatory regime. This will be explored here using data for Latin America and the OECD, and it is hoped that the analysis could later be extended to other regions.

The notion of a regulatory regime poses the question whether regulations in different domains of an economy exhibit a measure of interconnectedness, and whether this measure of interconnectedness is of sufficiently significant to characterise a broad range of regulation. The identification of regulatory regimes is a challenging task, because regulation usually develops on a piecemeal fashion and addresses very specific public policy objectives, because of the detailed and complex nature of regulation, and the even greater complexity of cross-country comparisons (many commentators use the more ambiguous notion of regulatory environment instead). At the same time, the need to examine regulatory domains together is usually an important component of policy discussions. In the context of developing countries, this arises, for example, in the context of coordinating environmental and foreign investment policy, or poverty and trade policy (McCulloch, Winters et al. 2001). It also arises in the context of discussions of the political economy of structural reforms. To the extent that regulatory domains are interconnected, reform in one domain will need to take account of regulatory reforms in other domains. Indeed, the substance, timing, and sequencing of reforms may be dictated by interconnected regulatory domains. Vittas, for example, discusses in some detail the sequencing of regulatory changes needed to facilitate social security reform in developing countries, which include a host of regulatory changes in government financial arrangements as well as in corporate regulations, regulation of the finance and banking sectors, and employment regulation (Vittas 1995).

The concept of a regime goes a step further, and is useful in the context of examining regulation. Inevitably, regulation is complex and highly differentiated across domains and countries. Identifying common or connected features in regulation across domains, and similarities across countries, can considerably facilitate discussion of regulatory structures and of their impact on development. The advantage of this approach is that the grouping of countries into a regulatory regime is not done at the expense of ignoring country specificities, or path dependence, and without the presumption of regulatory convergence. Discussing labour market regulation, for example, Freeman finds that there is significant variety in regulatory structures across advanced countries and also across developing countries, and little sign of convergence towards a single model (Freeman 1993, 1998, 2000). He also finds significant variation in outcomes (countries with similar regulations showing different outcomes, and countries with different regulations showing similar outcomes, on the relevant variables) and strong path dependence. In the domains of social security and labour market regulation, the use of welfare regimes as an organising concept has proved to be very useful (Esping-Andersen 1999; Gough 1999; Esping-Andersen and Regini 2000; Barrientos 2002).

The discussion in the remainder of this section will attempt to illustrate these issues using data from Latin America and the Caribbean (LAC) and the OECD.

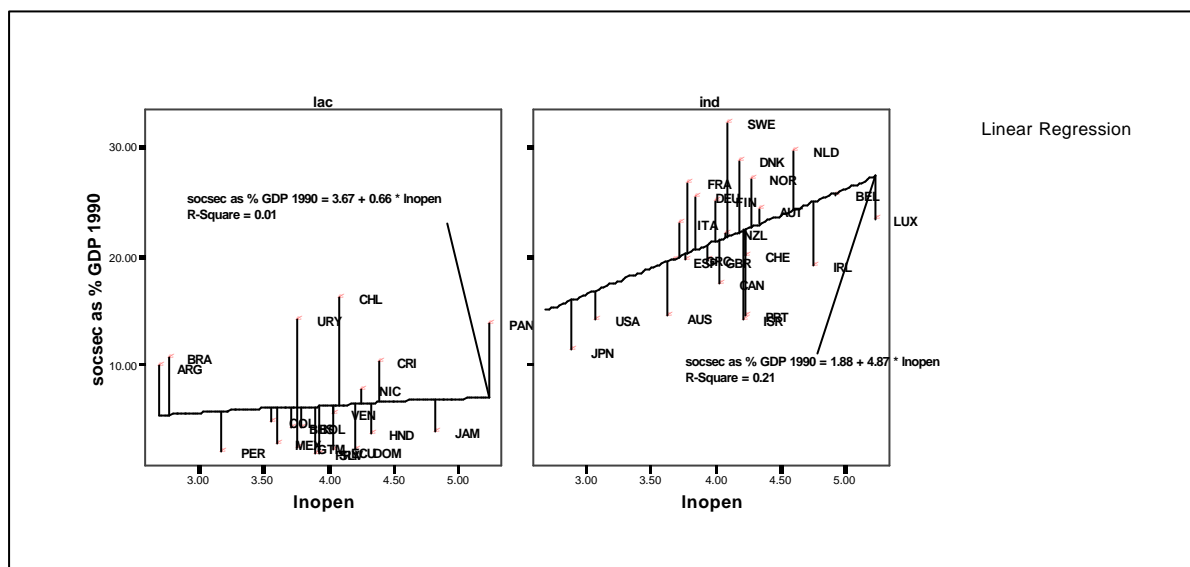
The discussion will initially focus on the connections existing between regulatory domains. In a study of advanced economies, Agell puts forward the hypothesis that “increased openness may lead to increased institutional involvement in the labour market” (Agell 1999, p.F160). This is also discussed by others (Rodrik 1996; Atkinson 1997), but there is little consensus on the links between increased openness, economic risk and volatility, and the demand for and supply of social protection (McCulloch, Winters et al. 2001). This provides an instance of the interconnectedness of regulatory domains.

A study by Nicoletti et al (2000) focuses on the connections between social protection and product market regulation also in OECD countries. There are few studies on the interconnections existing between these two domains. Their study generates a number of interesting and relevant findings. With regard to links between outward and inward oriented regulation, they find no close correlation between these two for the OECD countries studied. It appears that “high standards of openness to trade and international finance” are not carried over to domestic regulation (Nicoletti, Scarpeta et al. 2000, p.36). But they find that product market and employment protection regulations, defined by a broad array of indicators, are closely associated. As they put it, “restrictive product market regulations are matched by analogous employment protection legislation restrictions to generate a tight overall regulatory environment for firms in their product market as well as in the allocation of labour inputs” (Nicoletti, Scarpeta et al. 2000, p.51). The implications for the political economy of reform are also interesting, product market regulation must be accompanied by labour market regulation. One possible interpretation of the findings is that firms that are relatively sheltered from competition in the product market may feel less urgency in pressing for employment protection liberalisation. Along the domains of product market and employment protection regulation, OECD countries cluster into two groups: an Anglo-saxon group including the USA, UK, Canada, Ireland and Australia; and a continental European group, with some differentiation between Mediterranean and other countries. These clusters suggest the presence of regulatory regimes.

In the remainder of this section, data from Latin America and OECD countries is used to explore in a very informal way, the interconnectedness of regulatory domains and the possibility of identifying regulatory regimes.

As noted above, it has been argued that there is a link between openness and the extent of social protection in advanced economies. Figure 1 below plots the natural log of a measure of openness (imports plus exports over GDP) for early 1990s against social security spending as a proportion of GDP in 1990 (social security spending includes expenditure on pensions, health, disability, maternity, and housing, but excludes expenditure on education). The panels separate Latin American and Caribbean countries from OECD countries. The scatterplots show no relationship existing between openness and social security expenditure among LAC countries, but some positive association for these variables among OECD countries.

Figure 1



A possible link existing between product market regulation and employment protection is investigated using an index of the strictness of employment protection regulation for early 1990s on the one hand, and two indicators of product market regulation: a measure of firm entry costs standardised as a proportion of per capita GDP, and an index of formalisation of contract enforcement. The former measure is taken from OECD and IADB sources (Grubb and Wells 1993; IADB 1996; OECD 1997; Márquez and Pagés 1998); and the later measures come from the DoingBusiness Dataset compiled by the World Bank (World Bank 2002). These are the only indicators available from this dataset, which has only recently made available and is under construction. The planned expansion of the dataset to cover other areas will enable a wider, and more comprehensive analysis.

Figure 2 below plots costs of entry per capita GDP and an index of strictness of employment protection, again with separate panels for LAC and OECD countries. The relation existing between these variables is very weak, especially among LAC countries. This suggests that barriers to the entry of new firms are not correlated with employment protection regulations across countries selected. Figure 3 plots an index of formality in contract enforcement against the index of strictness of employment protection separating out LAC and OECD countries. A clear distinction between these two groups of countries can be observed. Among the LAC countries, the association between these two variables is very strong, indicating that product market and employment protection regulation may match along this dimension.

Figure 2

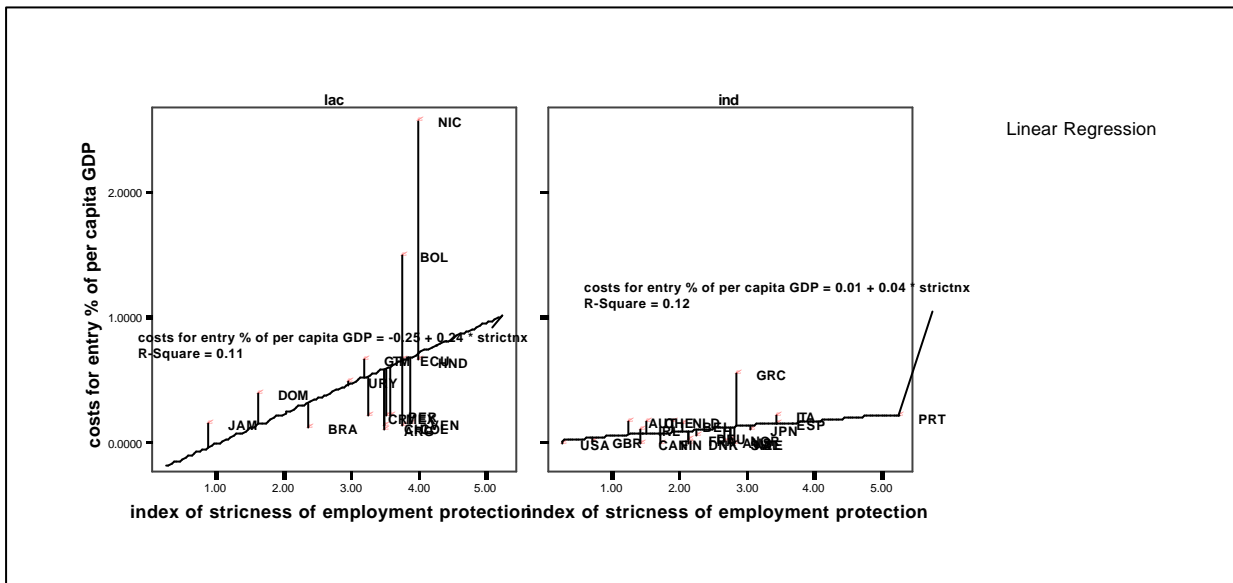


Figure 3

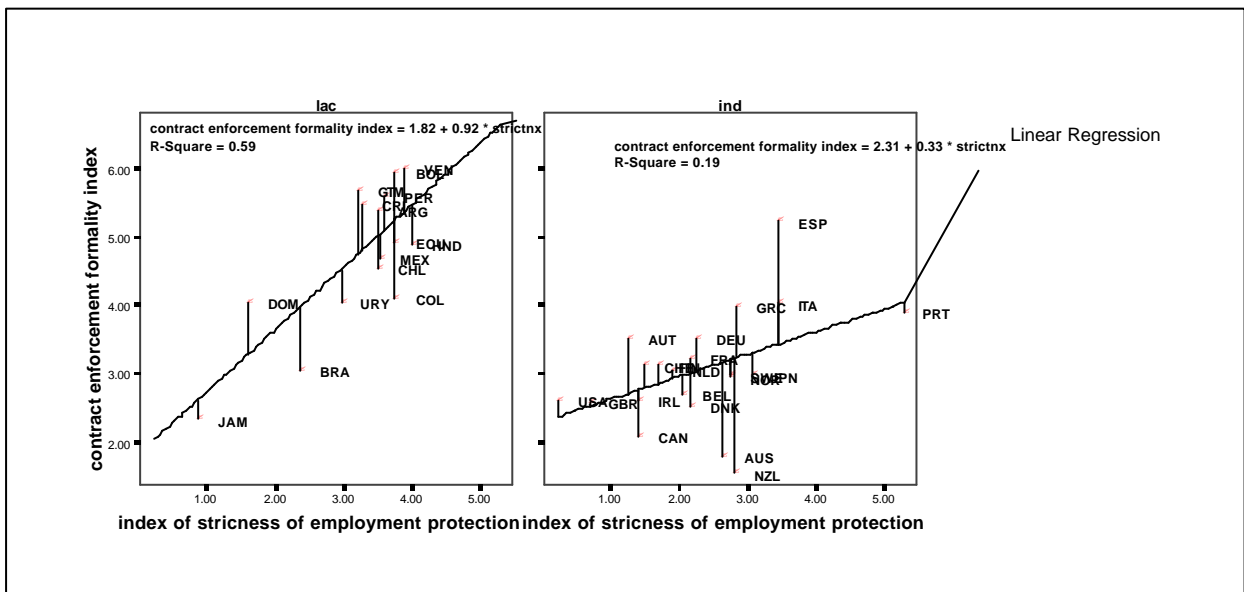


Figure 4 below shows the results from a basic clustering exercise, using the two measures of product market regulation, the index of strictness of employment protection, and the measure of social security expenditure as a % of GDP. The intention here is to investigate possible groupings of countries along the regulatory domains examined. A hierarchical clustering routine was used, which basically groups countries with similar scores until they are all in one group. The exercise suggests two basic clusters: one containing OECD countries, and the other



This is a very simplistic and unsatisfactory exercise, and a great deal of further work is needed to determine the data and variables to be used, and refine the methodology required. The exercise suggests the usefulness of examining linkages between regulation domains, and of including social protection and product market regulation among these. It also suggests that these linkages may be different for developing countries than those which have been observed in advanced economies. Attempting to identify regulatory regimes among developing countries may provide useful information. More work is needed to theorise these linkages and to pin them down empirically among developing countries. Examining social protection regulation can make an important contribution here.

### *Conclusions*

The paper discussed the implications of the growing consensus around social protection for regulation in developing countries. It began with a characterisation of social protection, and the reasons for its increasing dominance of the social policy agenda. Although there is a consensus on the need for developing countries to extend social protection, its scope and priorities are perceived differently by different agencies. Regulation is an important component of social protection, and the paper showed with specific examples, the import of social protection for regulation.

The extent to which social protection has implications for broader regulatory environments is more difficult to ascertain. In the context of developing countries, discussion of a wide range of development policy issues inevitably refers to the presence and importance of linkages between regulatory domains: trade and finance regulation, employment relationship regulation, environmental regulation, and others. The examination of these linkages is also important to the political economy of reform.

The paper argued for the potential advantages of identifying and evaluating regulatory regimes in developing countries. In a simplistic exercise, data on openness, product market regulation, and employment protection regulation, were examined for LAC and OECD countries, in an effort to see whether further work on this is warranted. The findings were mixed, indicating that to the extent that linkages between regulatory domains are present in developing countries, these may well be different to those observed among advanced economies. More work is needed to establish whether regulatory regimes can be identified among developing countries, but the paper has hopefully indicated the advantages of doing so.

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