

# Social Protection and Aid

**WIDER Development Conference,  
Helsinki, September 14, 2018**

Santiago Levy, IDB\*

\* Author's opinions do not necessarily coincide with those of the institution he is affiliated with.

# Need to distinguish between social insurance and poverty reduction

Objectives	Instruments
<p><u>Protection against risks</u></p> <ul style="list-style-type: none"> <li>✓ Illness</li> <li>✓ Longevity, death, disability, work-accidents</li> <li>✓ Output and employment shocks</li> </ul> <p>Note: <b>All</b> households are subject to risks</p>	<p>Social insurance programs</p> <p>Usually associated with worker’s status in the labor market.</p> <p>Usually financed with wage-based contributions</p>
<p><u>Redistribution/poverty reduction</u></p> <ul style="list-style-type: none"> <li>✓ Equity and poverty reduction as good in their own right</li> <li>✓ Equity and poverty reduction because with imperfect credit markets some forms of redistribution increase efficiency</li> </ul> <p>Note: <b>Only</b> for poor/low income households</p>	<p>Social assistance or poverty programs</p> <p>Usually targeted transfers based on income or asset indicators, but sometimes on labor status</p> <p>Almost always financed from general revenues</p>

**Objective:  
Insurance against risks**

		<b>Objective: Insurance against risks</b>	
		<b>Contributory (formal)</b>	<b>Non-contributory (informal)</b>
<b>Objective: Redistribution</b>	<b>Non-Poor</b>		
	<b>Poor</b>		

In most countries in Latin America, and in other regions of the world, access to social insurance depends on workers' status in the labor market. This impacts:

- The population covered
- The risks against which households are protected (illness, longevity, disability, unemployment, and so on), and
- The behavior of firms and workers with spillover effects on productivity and growth.

# Asymmetry in social insurance, CSI and NCSI

Salaried (dependent) workers: bundled benefits, usually health, work-risk, death and disability insurance, retirement pensions, and protections against loss of employment

- benefits paid from earmarked wage taxes, hence the (mis)label of “contributory” social insurance, CSI
- benefits may also include labor training (Colombia), housing (Mexico), child allowances (Argentina).

Non-salaried (non-dependent) workers: until recently, uncovered by social insurance. But since 1990s unbundled pension, health and related programs

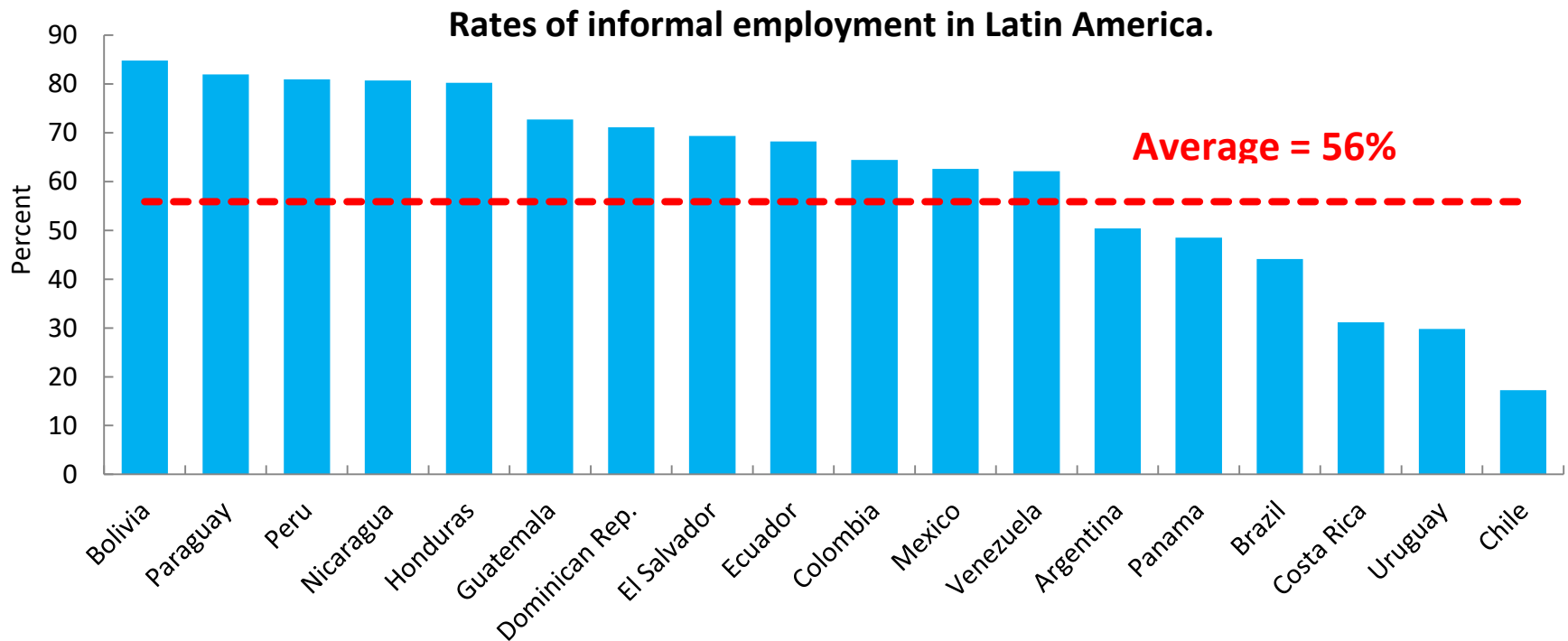
- benefits paid from general revenues, hence the (mis)label of “non-contributory “ social insurance, NCSI
- benefits targeted to workers not covered by CSI (often regardless of whether they are salaried or not).

# Three problems with CSI

## 1. Limited coverage:

By construction, only salaried workers whose firms comply with the law; many legally left out (self-employed, rural workers, part-time workers).....and many illegally so.

Even under full compliance, CSI will not deliver universal coverage.

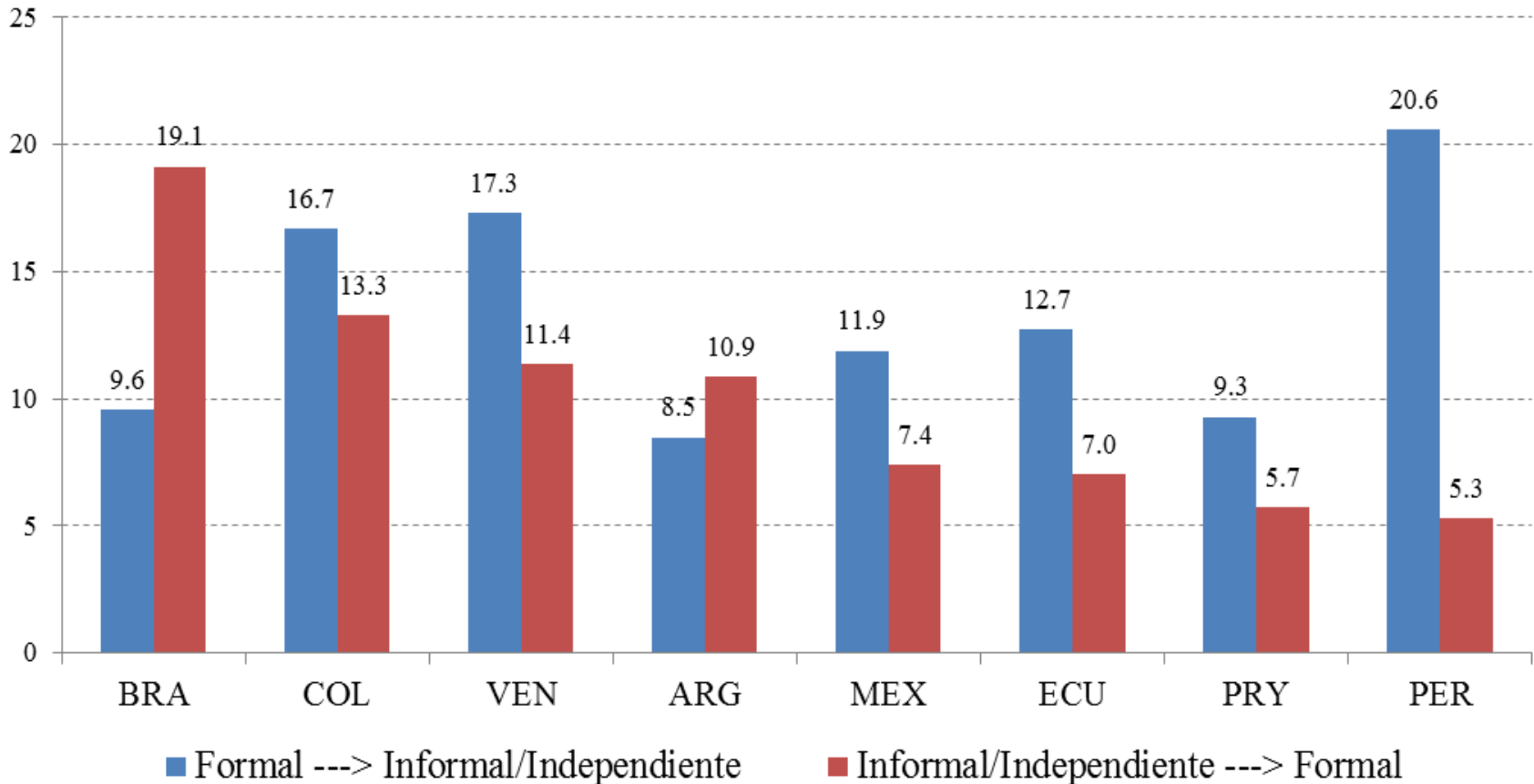


## 2. Under-valuation of benefits:

- Firms pay  $(w + \alpha w)$ .
- Workers might not consider that  $\alpha w$  is worth  $\alpha w$  to them (because of quality problems, trust, or simply differences in preferences from the government).
- In this case, there is an implicit tax since workers get  $(w + \text{less than } \alpha w)$ .
- This implicit tax on formality induces firms to limit salaried employment and/or to evade the Law. In either case, the result will be reduced legal salaried employment, further reducing the coverage of CSI.

### 3. Large transits across labor status

Probability of change of status in one year



# Implications for social welfare

- Distinction between “formal worker” vs. “worker at present hired formally”. Many workers have spells of formal and informal employment during their life-cycle.
- Coverage against risks erratic and incomplete: when formal yes, when informal, partially.
- Efficiency of social insurance much diminished:
  - workers get lower quality health care (interrupted treatments),
  - many will not get a pension (insufficient years of contribution).



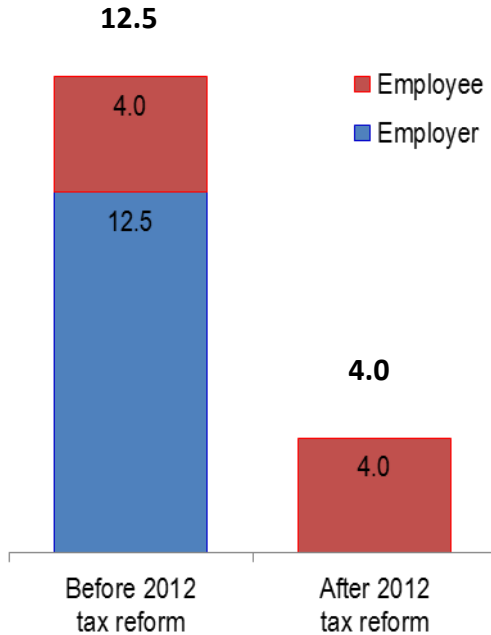
# Implications for productivity

- Firms change the contracts that they give to workers to elude  $\alpha w$ .
- Firms reduce their size to evade  $\alpha w$ .
- Economies of scale and scope under-exploited; illegal behavior limits firm's access to credit; tiny firms have short lives; large firm churning.
- Workers' transits from job-to-job impede on the job learning and reduce the opportunities for training, lowering their productivity and their earnings over their working life.

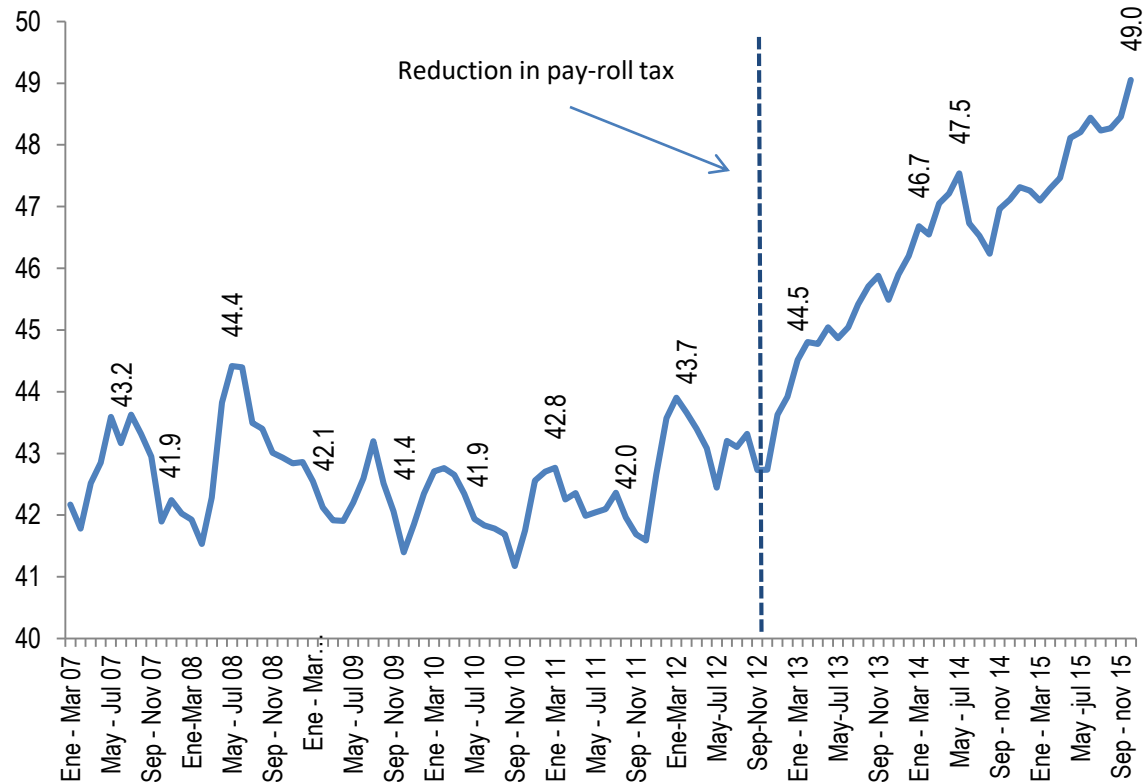
# Evidence from CSI programs

## Reducing the tax on formality: 2012 tax reform in Colombia

Contributions



Share of workers contributing to pensions

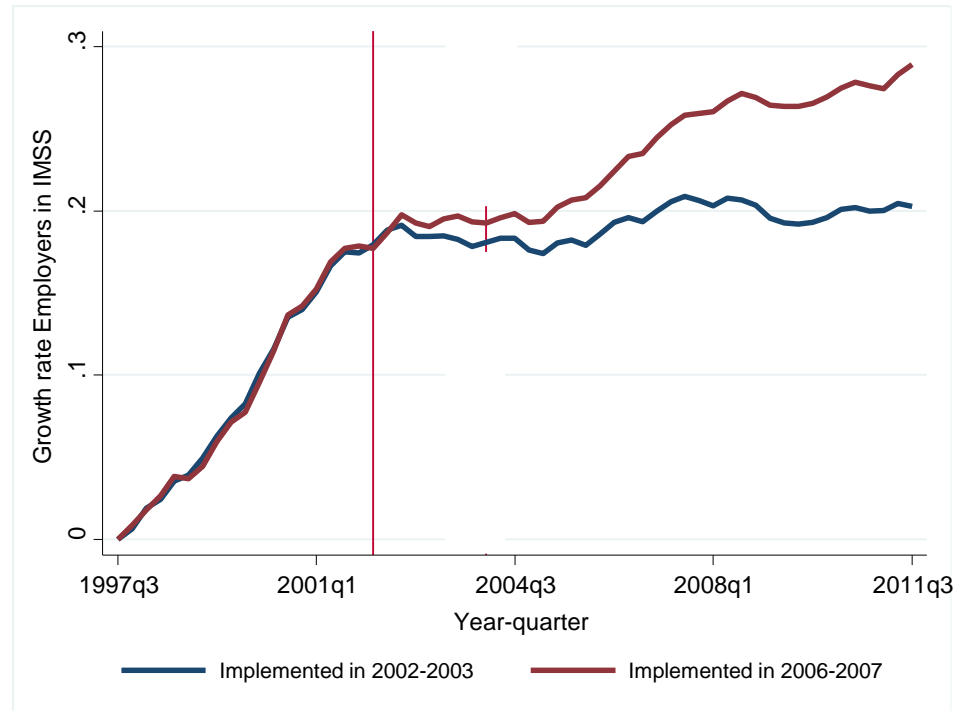
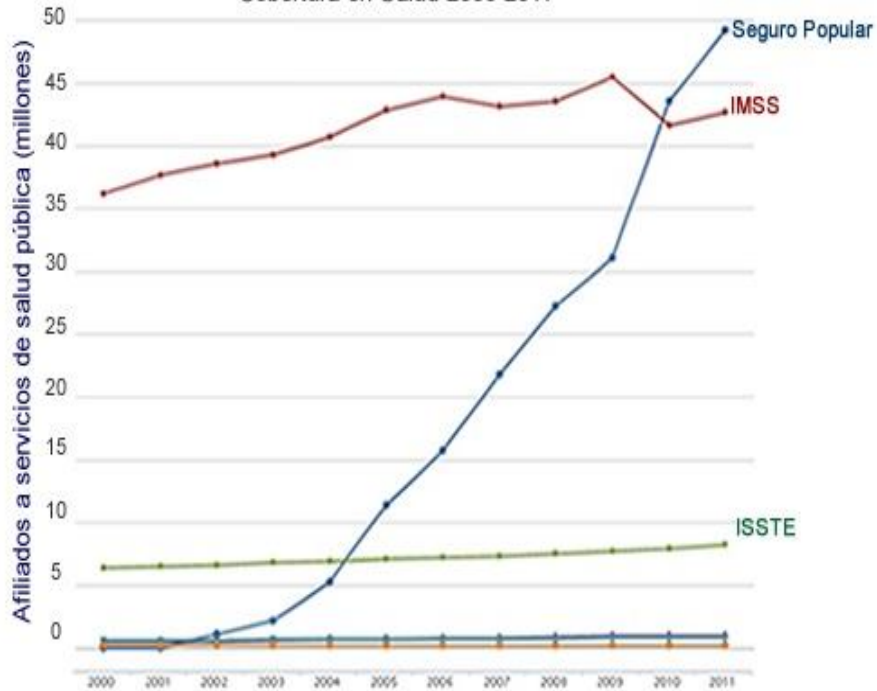


# Non-contributory programs to the rescue?

- Beginning in the 1990's, many countries in LA extended the coverage of social insurance to workers excluded from CSI, through NCSI.
- These programs are unbundled and financed by the government, with no firm involved.
- Benefits vary but in most countries they involve health services, retirement pensions, and sometimes other benefits.
- From a social point of view, NCSI programs are clearly welcome.
- However, from the economic point of view they are a subsidy to informality, which adds to the effects of the tax on formality associated with under-valued CSI programs.

# Evidence from NCSI programs, Mexico

Cobertura en Salud 2000-2011



Reviewing the various papers, Bosch and Pages (2012) find that from 2002 to 2010, Seguro Popular reduced formal employment by between 160,000 to 400,000 jobs, or between 8 and 20% of all formal jobs created during that period.

This difference also provides indirect evidence of higher evasion by firms.

# Incentive problems between poverty and [CSI + NCSI] programs

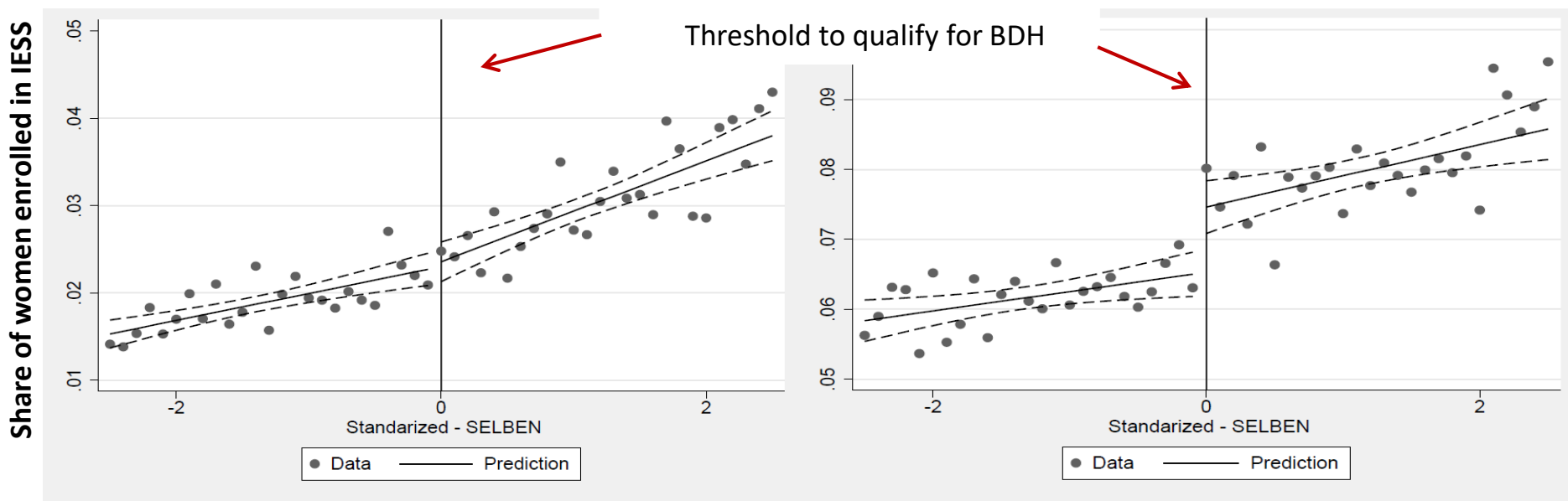
- Poverty programs like CCTs should target workers by income levels, not by labor status. Conditioning them on being informally employed will make it more difficult for poor workers to be formally employed.
- The formal-informal status of poor workers is endogenous to the incentive structure implicit in CCT and [CSI+NCSI] programs.
- Poor workers may end up locked in informal jobs in low productivity activities.
- **Young poor workers may be healthier and more educated than their parents as a result of CCT's but they will not access better jobs.**

# Evidence from CCTs with benefits conditional on informal status

Effect of Ecuador's Bono de Desarrollo Humano (BDH) on Affiliation to CSI  
(panel data, women 35 to 65 years of age)

Base line, 2002,  
all households without BDH

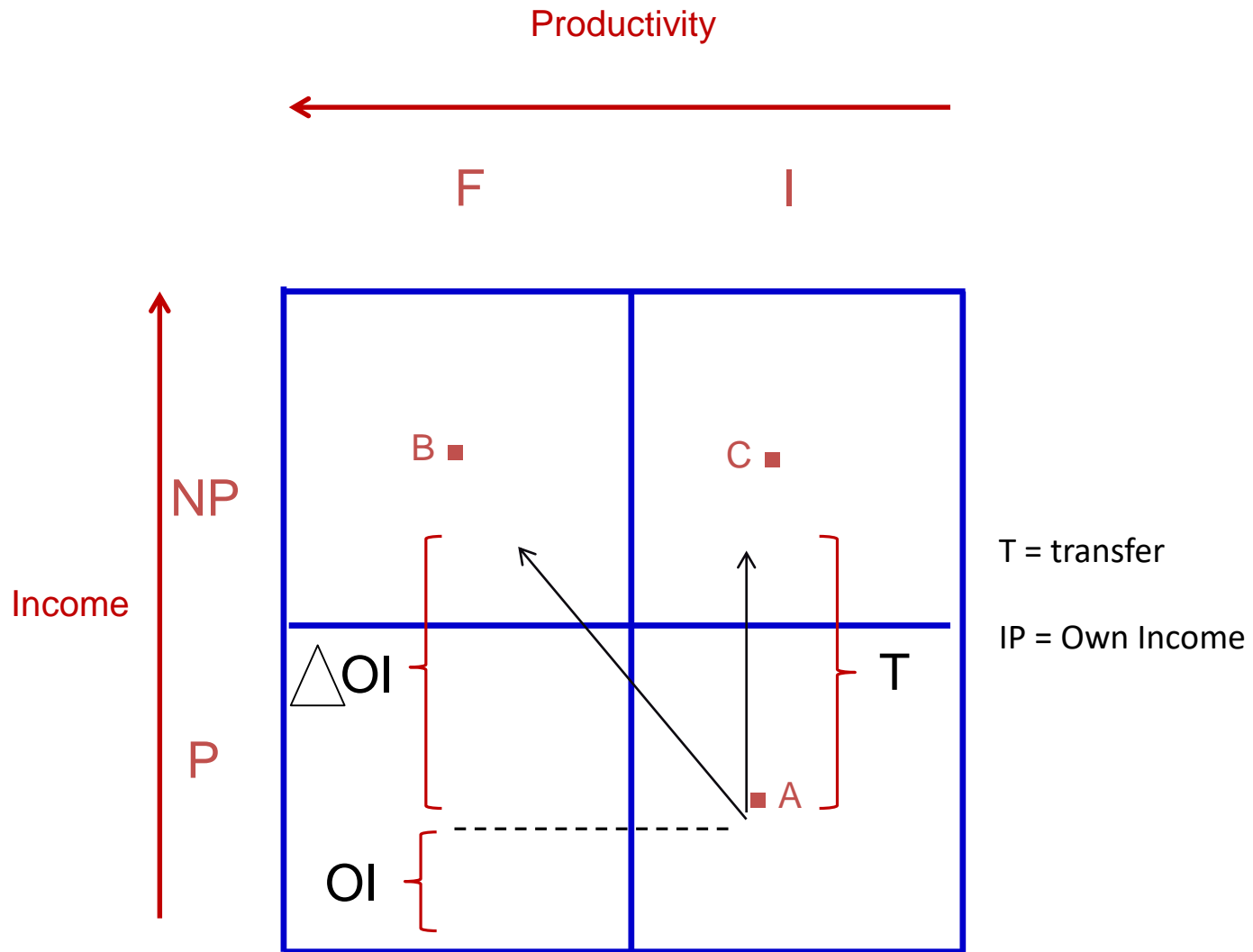
2008-2009, 6 years of BDH  
with without



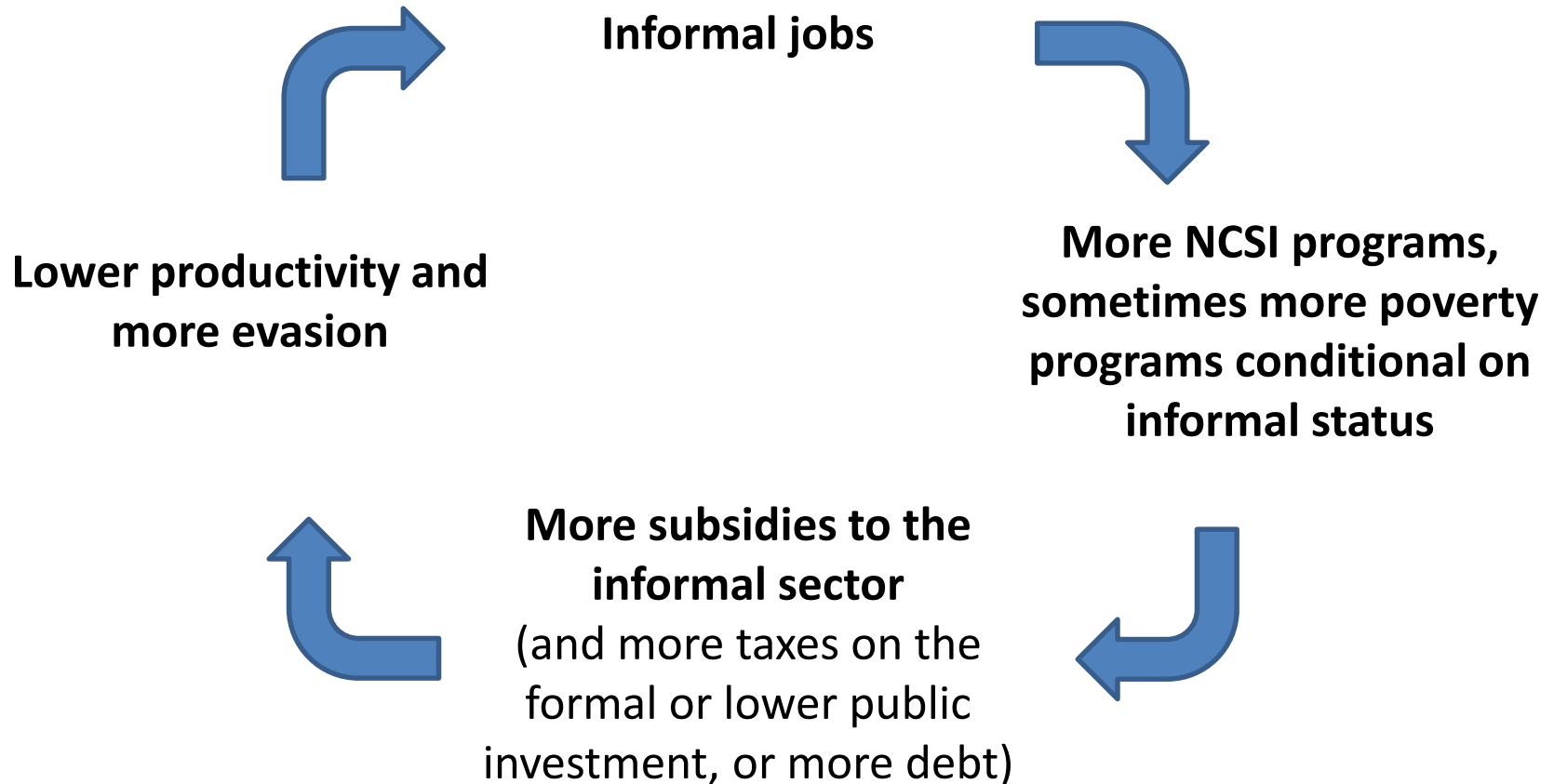
Source: Bosch and Schady (2013).

After six years, the BDH reduced formal employment of working women by 15%.

# A Simple but Useful Perspective



# The current architecture of social protection creates a vicious circle between informality and low productivity



This vicious circle partly explains why TFP has stagnated in Mexico in the last two decades.



# Conclusions

## Social insurance

- Countries need to escape from the dilemmas created by the CSI-NCSI dichotomy. Broadly, they need to transit towards unified regimes. There are strong equity and efficiency reasons for “universalism”.

## Social assistance/poverty

- Income transfer programs for the poor (CCTs and the like) should avoid conditioning on poor workers' status in the labor market.
- In parallel, poor workers should be protected against risks through the same mechanisms as all other workers (i.e., by the same social insurance programs).

## General

- LA's experience shows that it is central to consider the **incentives implicit in social programs**. Who qualifies for what? Who pays for what? How do households, firms and workers react to those rules and differences in revenue sources?
- Debate centers on “architecture” of social protection, not on individual programs. **An integral view that ensures incentive compatibility across all programs is essential.**
- We need to go beyond the usual impact evaluation of individual programs and develop a view of how all the pieces of the puzzle fit together.
- These issues need urgent attention, as countries may be constructing Welfare States in economies characterized by permanent informality, weak fiscal basis and low productivity growth.

**Thank you.**