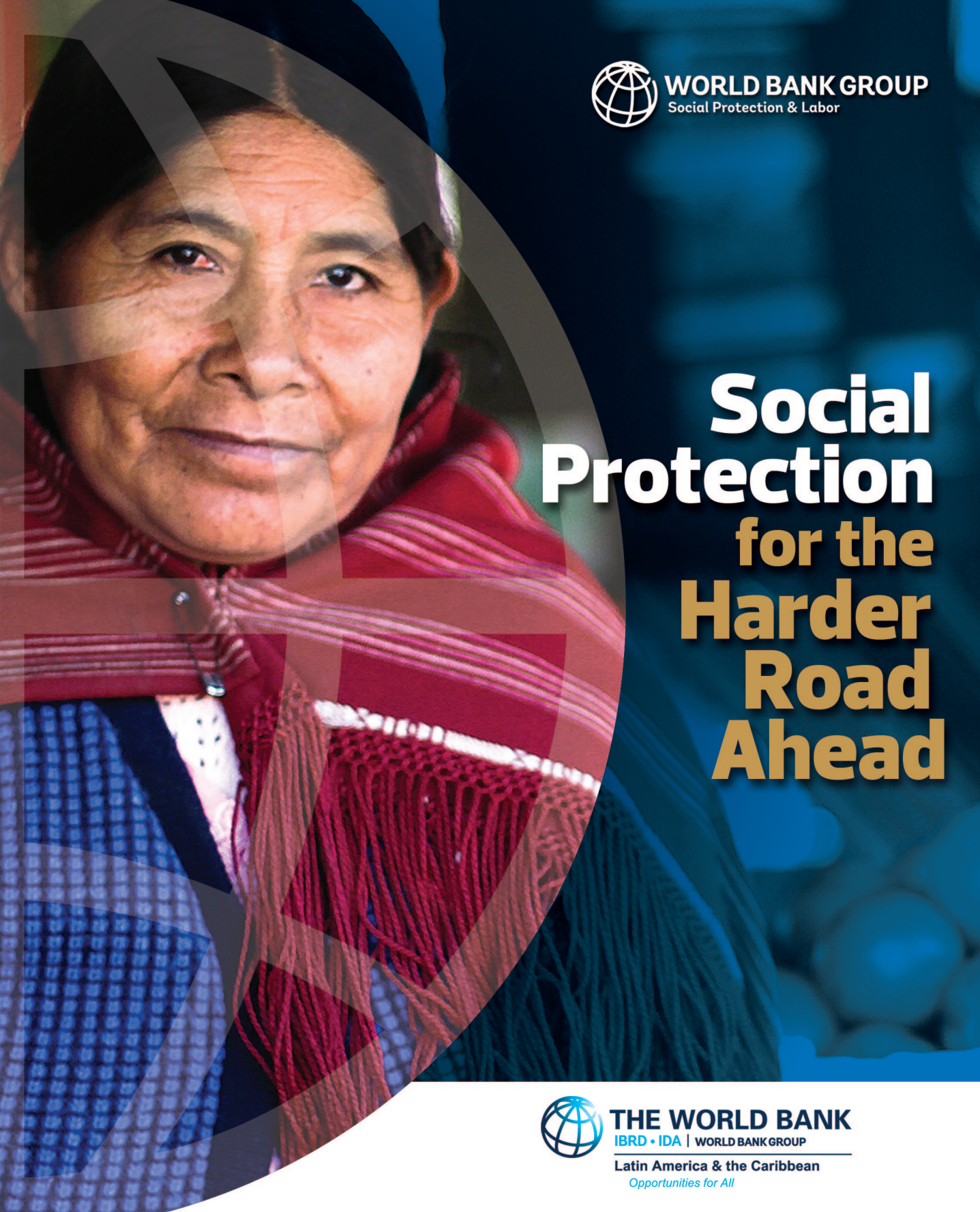

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Social Protection for the Harder Road Ahead

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Social Protection for the Harder Road Ahead:

Containing the social costs of lower growth in Latin America and the Caribbean

During a decade of rapid growth, more jobs and higher wages dramatically reduced poverty and drove down historically high levels of inequality. Governments in the region complemented the gains from growth with investments in social protection policies, further reducing poverty and inequality. Countries in Latin America and the Caribbean are rightfully proud of these achievements.

As the region prepares for a long period of slower growth and tighter budgets, the value of their investment in building social protection systems will grow. Social protection can help protect social gains as labor earnings and employment fall. The evidence accumulated from the region's experience of which social protection interventions work and which do not, will be an essential resource to guide difficult policy decisions.

Countries will move ahead with the long run development of their diverse social protection systems as they are able. But in the shorter run three areas of policy action will rise in priority: (i) protecting poor and vulnerable people through the lean years; (ii) finding fiscal savings in reforms to large and regressive items of social policy; and (iii) fielding labor market initiatives to support workers during a long, slack period and prepare them for economic recovery.

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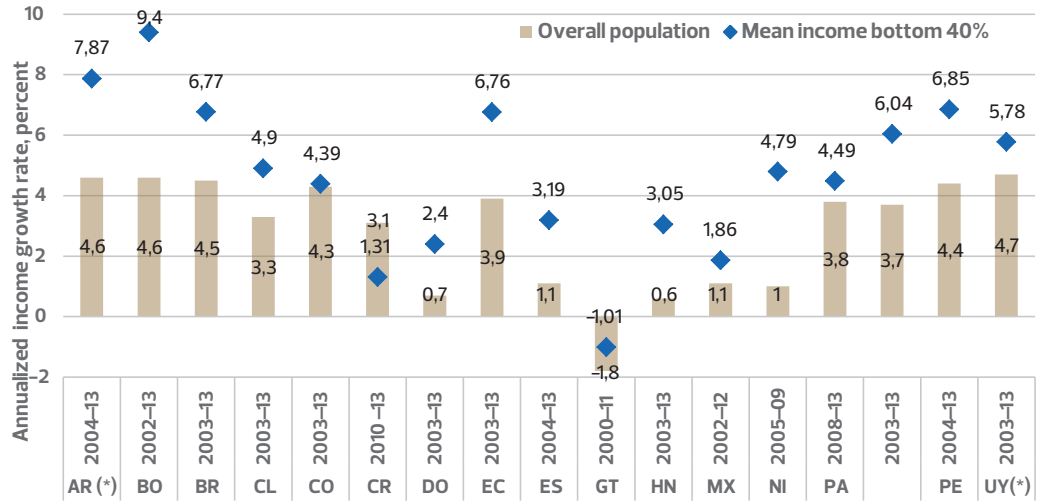
Section I: The Road thus Far

In the wake of rapid economic growth, the region has achieved a remarkable reduction in poverty. Poverty in Latin America and the Caribbean fell by more than 16 percentage points in almost a decade, going from 41.6 percent of the population living with less than $4/day in 2003 to 25.3 percent in 2012. As a result, 70 million people moved out of poverty. The region has also achieved impressive gains in reducing extreme poverty, halving the number of people living with less than $2.5 dollars a day since 2003, down to 13.3 percent in 2012 (World Bank 2013).[1]

Years of high growth were also accompanied by a reduction of inequality and better shared prosperity. Sustained economic growth, and inequality reduction efforts led to a notable rise in the incomes of those at the bottom of the income distribution. The income of the poorest 40 percent grew faster than the income of the overall population in most countries in the region (see Figure 1), and the regional Gini coefficient for per capita income decreased by five points from 0.57 in 2000 to 0.52 in 2012. In 2011, for the first time, Latin America and the Caribbean had more people in the middle class (as measured by a $10/day threshold) than it had living in poverty. This change is largely due to the reduction in inequality that came about through faster and more equitable income growth, and is driven by performance of countries in the Southern Cone where the middle class is the largest economic class (World Bank 2013).

Figure 1. Annualized Income Growth of Poorest 40 Percent Relative to Overall Population, Latin American and Caribbean Countries

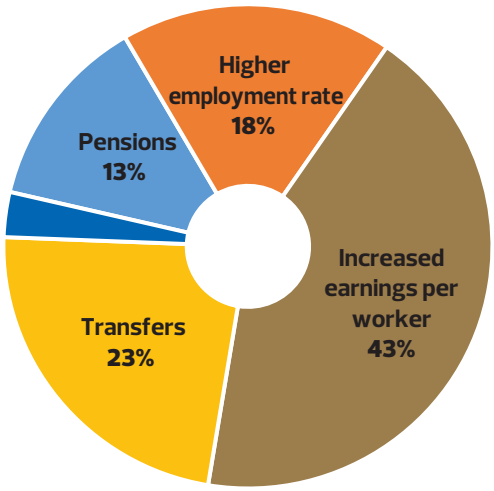


Source: LAC Equity Lab tabulations of SEDLAC (CEDLAS and the World Bank) and World Development Indicators.
Note: Because the numbers presented here are based on SEDLAC, a regional data harmonization effort that increases cross-country comparability, they may differ from official statistics reported by governments and national statistical offices. In cases where data are unavailable for a given country in a given year, values have been interpolated using WDI data to calculate regional measures. The Latin America and Caribbean aggregate is based on 17 countries in the region for which micro data are available at the national level. Urban and rural poverty rates are not available for the Latin America and Caribbean aggregate or subregions. (*)Only urban data.
Note: AR=Argentina, BO=Bolivia, BR=Brazil, CL=Chile, CO=Colombia, CR=Costa Rica, DO=Dominican Republic, EC=Ecuador, ES=El Salvador, GT=Guatemala, HN=Honduras, MX=Mexico, NI=Nicaragua, PA=Panama, PE=Peru, PY=Paraguay, T&T=Trinidad and Tobago, UY=Uruguay

1 The global extreme poverty line, which is used frequently to compare extreme poverty levels around the world is $1.25/day. But the level of economic development of the Latin America and Caribbean region has led analysts to more often use an extreme poverty line of $2.50/day, and a poverty line of $4/day. Poverty lines and incomes are expressed in 2005 US$ PPP (Purchasing Power Parity).

Growth in employment and earnings was central, but social policies also contributed to reducing poverty and increasing shared prosperity (see Figure 2). 61 percent of the decline in poverty in the region in recent years can be attributed to higher labor incomes, with more people working and workers earning more. Women's higher earnings are responsible for 21 percent of the decline in poverty, and males' earnings for 40 percent. Moreover, proceeds from transfers accounted for 23 percent of this reduction, while pensions contributed 13 percent, and other non-labor income the remainder (World Bank 2013).

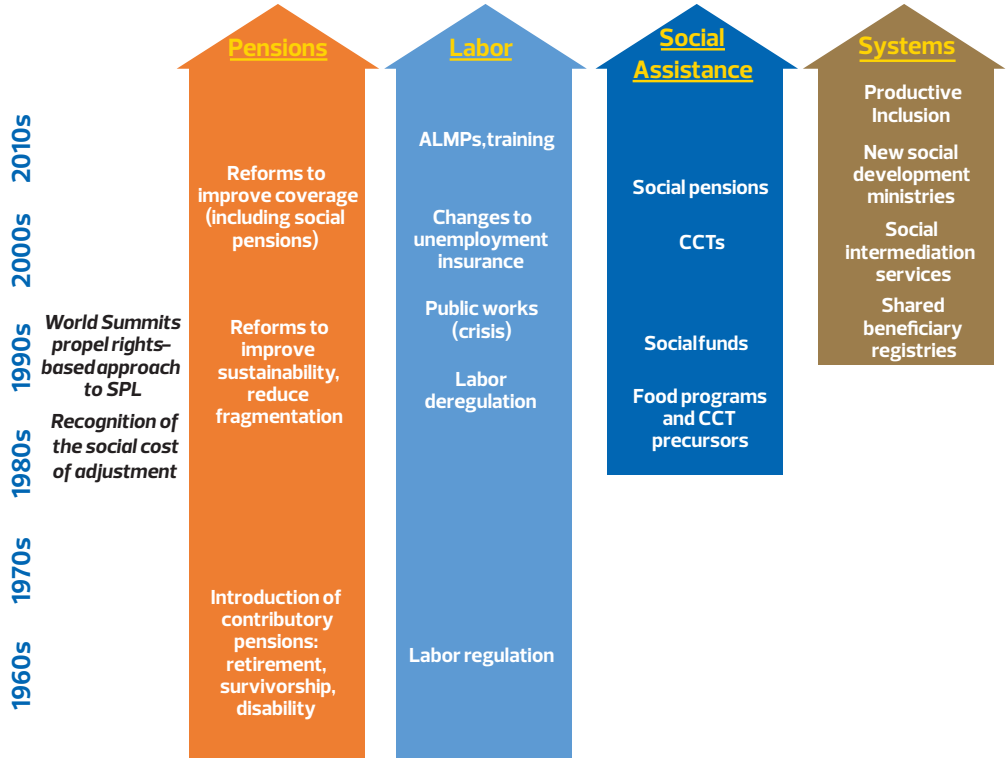
Figure 2. Reduction in poverty in Latin America and Caribbean: Share of income change due to various factors



Source: World Bank 2013

During this period, social protection programs—noncontributory cash transfers in particular—were dramatically expanded, fueled by the greater fiscal yields of rapid economic growth. The importance of social protection in addressing poverty, inequality, and exclusion is more widely recognized than ever before. The past 10 to 20 years have seen the creation of conditional cash transfer (CCT) programs; the expansion of coverage of the elderly and disabled through social pensions; more attention to active labor market programs, especially for young people; and the initial development of integrated service delivery mechanisms to more accurately identify target households and deliver benefits more efficiently. With the gradual introduction in recent years of significant noncontributory elements in the social protection system the traditional truncation of the welfare state, that created formidable obstacles to protection, is being addressed (see Figure 3).

Figure 3. Evolution of Social Protection Policies in the Latin America and the Caribbean Region



Section II: The Harder Road Ahead

After a decade or more of sustained expansion that started in 2000, economic growth has started to slow in the region, and fiscal space is decreasing. Average GDP growth has been steadily slowing, from close to 4 percent in 2011 to around 1 percent in 2014, and it is projected to reach only 0.8 percent in 2015 (World Bank 2015e). Although the deceleration rates are not uniform across countries (with some of the largest economies—Brazil, Chile, Peru and Venezuela—leading the downward trend), most countries are likely to face a combination of monetary and fiscal policy constraints that could affect their social expenditures and capacity for policy maneuver (World Bank 2015e). Government budgets are being squeezed.[2] The ample fiscal space that had been available during the 2008–09 economic crisis enabled countercyclical public spending, including increased social protection, and contributed to the region's early recovery. But this cushion is now largely gone, and the relative lack of fiscal space restricts countries' capacity to engage in countercyclical spending. The problem is especially acute in the Caribbean and Central America (World Bank 2015e).

2 As World Bank (2015e) points out, the policy maneuvering space is increasingly limited also on the monetary policy side, where central banks are struggling to maintain inflation levels in the face of steady currency depreciations that are passing though via higher consumer prices. The threat of higher inflation rates is especially damaging for the poor and vulnerable given the higher than average consumption share of their budget.

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Despite fiscal pressures, the expectations to address exclusion in the region remain high, and slower growth increases the need for social protection. Governments will be expected to continue to achieve social gains, but as growth decelerates, the pace of poverty reduction is expected to stall and employment to slacken. In Brazil, new-job creation began to stall in 2013 (Silva et al 2015) and at 7.5 percent, unemployment in July 2015 was already 2.6 percentage points above its July 2014 rate (World Bank 2015c). In Mexico, poverty reduction is also stalling, driven by small increases in monetary poverty even as the country has shown modest improvement in relieving other dimensions of deprivation such as access to health and support for the elderly and disabled, housing and education.[3] (CONEVAL 2015).

The arsenal of social protection programs can be effectively deployed to help contain the social costs of low growth and tighter fiscal constraints. Countries in the region have somewhat different social contracts and are at different stages of developing their social protection systems. A longer run agenda to develop these systems is already being pursued by policy makers. However, with slower growth, slower poverty reduction, slack labor markets and reduced fiscal space, three new areas of action rise quickly in priority:

- protecting the poor and people made vulnerable through the period of slower growth;
- finding fiscal savings in reforms to large and regressive items of social policy;
- fielding labor market initiatives to prepare working people for economic recovery.

2.1. Protecting the poor and people made vulnerable through the period of slower growth

The wave of programming, innovation, and evaluation in social protection—especially innovations in social assistance with the establishment of the conditional cash transfers and social pensions—has begun to repair the historical truncation of the welfare state in Latin America and the Caribbean.[4] These programs, their innovations, and their successes need to continue and to improve. Falling earnings and job losses will create demand for policy responses. Governments will need to be ready to help households manage shocks to earned income, and contain the possible effects on workers and the work force of unemployment and discouragement.

2.1.a. Protecting the gains in poverty reduction

Extensive and rigorous evaluations of social assistance programs show their value to protecting poor and vulnerable people and helping put them on a positive trajectory. Many social assistance programs in Latin America and the Caribbean are well designed and implemented. The conditional cash transfer (CCT) programs in particular have been extensively assessed. In almost every case and despite variations in design, the programs reduce poverty, have increased use of health and school services. Depending on both the specificities of the program's design and of their evaluations, the programs have shown the ability to affect, usually to a modest degree, final outcomes such as nutrition, health, mental health, school completion, and learning. These gains have been made with little impact on the

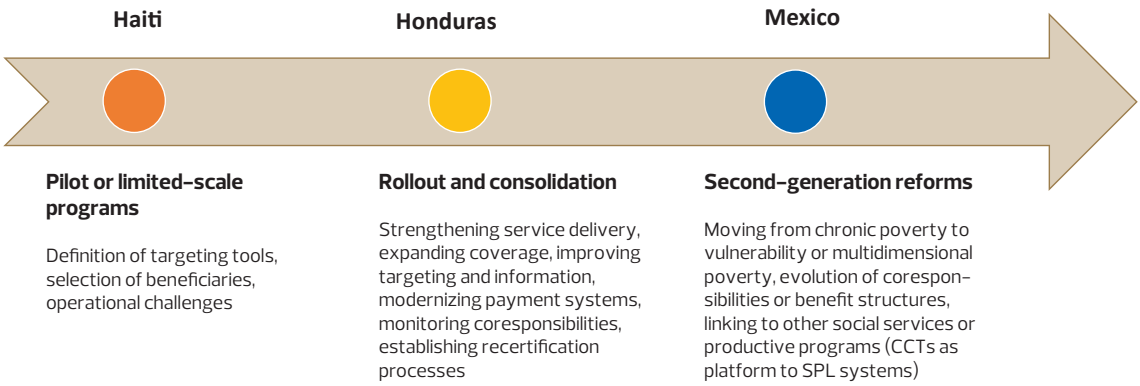
3 Mexico was the first country in Latin America to adopt a multi-dimensional Poverty Index as its official poverty measure in 2008. The multidimensional poverty measure was defined by the National Evaluation Council (CONEVAL) as a combination of income poverty and a set of deprivations (nutrition, education, social security, basic services, access to health services, and quality and space of the dwelling).

4 Latin America and the Caribbean, "truncated" social policies tied benefits to formal sector employment, having the effect of "cutting off" many of the poor and vulnerable from social expenditures as the region's welfare states were built.

labor supply of adults (DFID 2011; Fiszbein and Schady 2009; IEG 2011). Evaluations of school feeding programs are less abundant but also generally positive; they show improvements in school attendance and, to a lesser degree, schooling performance and child health (Adelman, Gilligan, and Lehrer 2008; Bundy et al. 2009; WFP 2013). Evaluations of social pensions programs are mixed, sometimes showing reductions in work effort among the elderly but sometimes also showing increased household earnings as the households either use the cash to alleviate constraints to their own-managed enterprises or rearrange labor among generations. A review of recent Latin American youth employment programs found that these initiatives affected at least one employment indicator positively (CEDLAS 2013).[5] Not all programs perform equally well, however, so there is plenty of room for improvement.

Social assistance programs remain pertinent, but there is plenty to be done to improve, which may become more urgent in the coming period of low growth. Most continental and a few Caribbean countries have had CCTs in place for several years now. The agenda is broad, with priorities including consolidation of operational tools and administrative systems, especially in younger programs. In some cases modifications to target groups, co-responsibilities and benefit structures to improve impacts is appropriate (figure 4). In Honduras, for example, the Bono Vida Mejor (Better Life Voucher) is focusing efforts on strengthening operations by improving payment and grievance and redress mechanisms. It is retargeting to focus on the extreme poor rather than all poor. It is also refining program design by switching from a flat payment structure to a payment per child or student and by introducing a new transfer for children in lower-secondary school to counter the high dropout rates during transition to secondary school (World Bank, 2014).

Figure 4. Progression of Development for CCT Programs

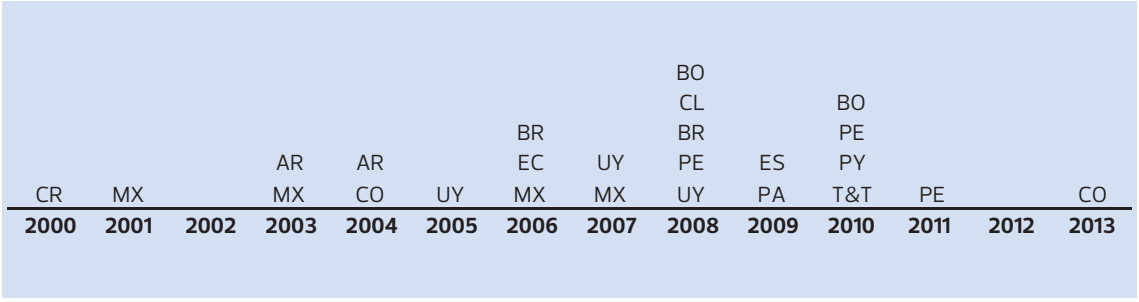


Note: CCT = conditional cash transfer. SPL = social protection and labor.

5 Of the 65 programs tallied in the CEDLAS (2013) study, 12 had rigorous impact evaluations and 7 had cost-effectiveness evaluations.

Latin American and Caribbean countries have been substantially extending coverage of old-age income security, often via non-contributory social pensions. Between 2000 and 2013, at least 18 countries in the region introduced new programs or significant reforms to increase coverage (figure 5). Bolivia, Colombia, Costa Rica, Ecuador, El Salvador, Mexico, Panama, Paraguay, and Peru expanded coverage via noncontributory or "social" pensions that had little interaction with the traditional contributory programs. In some cases (Ecuador, Panama, Paraguay, and Peru), these new programs are run by the same agencies that handle social assistance for poor families with children. Argentina, Brazil, Chile, Trinidad and Tobago, and Uruguay have introduced significant reforms to their contributory schemes to improve coverage, in general allowing those with insufficient years of service to earn a minimum pension (Rofman, Apella, and Vezza 2014). These changes have begun to redress the truncation of the Latin American welfare state long known for low coverage overall and that highly skewed toward the upper end of the welfare distribution.

Figure 5. Timeline of Reforms to Increase Coverage of Old-Age Pensions in Latin American and Caribbean Countries, 2000–13



Source: Adapted from Rofman, Apella, and Vezza 2014.
Note: AR=Argentina, BO=Bolivia, BR=Brazil, CL=Chile, CO=Colombia, CR=Costa Rica, EC=Ecuador, ES=El Salvador, MX=Mexico, PA=Panama, PE=Peru, PY=Paraguay, T&T=Trinidad and Tobago, UY=Uruguay

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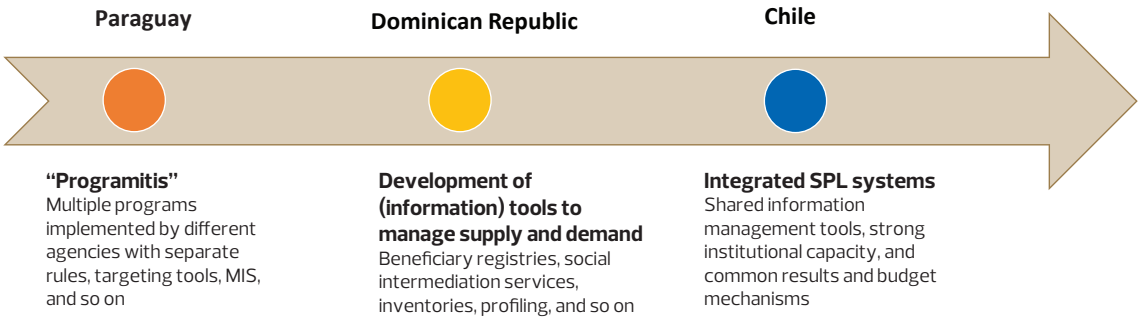
With larger and more sophisticated social programs, countries have started to look for ways to increase overall effectiveness and efficiency by integrating and coordinating the provision of services. Following the rise in implementation of social programs that started in the late 1980s, Latin American countries began to develop tools and strategies that could help them manage the rapidly growing number of social programs implemented by different agencies (often outside of the traditional "social" ministries but that responded more broadly to poverty reduction efforts). Social registries and program inventories are being used to help social programs identify, locate, and reach the poor who are underserved as well as to identify which programs are duplicating efforts by targeting the same population with the same services. Initially, these efforts were led by countries such as Brazil, Chile, and Colombia. Their efforts to establish shared targeting instruments for multiple programs (Brazil's Cadastro Único [Single Registry], Chile's Ficha CAS [CAS Card], and Colombia's SISBÉN)[6] as well as social intermediation services to link beneficiaries to existing supply of programs (Brasil Sem Miséria, Chile Solidario, and Unidos in Colombia) opened the way for other countries to develop similar tools. In the 2000s, a wave of institutionalization and integration efforts led to the creation of new institutions for the coordination and implementation of social protection programs (for example, new ministries of social development in Chile, Colombia, Guatemala, and Peru, as well as the creation of a number of inter-ministerial committees). Integration of service provision and improved coordination has significant potential to increase the effectiveness—and efficiency—of the social protection system as a whole (see Figure 6).

Figure 6. Development of Social Protection Systems' Delivery Tools



Note: SPL = social protection and labor. MIS = management information systems

The capacity and experience built to date will provide a good basis for protecting poor and vulnerable people during hard times ahead. The expansion of coverage and increase in benefits for Mexico's Oportunidades program was effective in softening the blow in one of the countries hardest hit by the 2008/9 Global Financial Crisis. Without the program changes, the incomes of people in the poorest decile would have fallen by about 8 percent. However, with the changes their incomes dropped only about 2 percent. Mexico was not alone in taking such action. Following the 2008/9 Global Financial Crisis, 19 countries in the region expanded their cash transfer programs by increasing coverage (5 countries), benefit levels (3 countries) or both (11 countries). However, to serve better as social assistance during

6 CAS = Comités de Asistencia Social (Social Assistance Committees). SISBÉN = Sistema de Identificación de Potenciales Beneficiarios de Programas Sociales (System for Selection of Beneficiaries for Social Programs).

a downturn, and especially to help vulnerable people who move in and out of poverty, the region's cash transfer programs need to have three features that are presently rare. They need to: (i) have budgets that increase along with need, without waiting lists for entry; (ii) receive applications continuously rather than only in periodic retargeting procedures; and (iii) have targeting criteria that consider current income as part of eligibility rather than relying only on longer run correlates of chronic poverty as do many of the region's proxy means tests (Grosh, Bussolo and Freije, 2014).

2.1.b. Protecting the newly vulnerable unemployed from the pain of slackening labor markets

In the context of slowing growth, governments in the region will face the challenge of providing effective and incentive-compatible income support to the unemployed as they look for new jobs. The larger, higher-income countries (including Argentina, Brazil, Chile, Colombia, Ecuador, Panama, Peru, and Uruguay) have introduced unemployment insurance (UI) or unemployment insurance savings accounts (UISAs) but even in these countries, only about 22 percent of the unemployed received benefits during the 2009 Global Financial Crisis because informality and job turnover leave workers without the required contribution history to be covered (Vroman and Brusentsev, 2009). As part of the crisis response, most Latin American and Caribbean countries with national unemployment insurance plans changed the rules to expand coverage, at least temporarily, the Bahamas introduced a temporary program, and Mexico introduced but has not yet passed legislation for unemployment insurance. But there is more to do to build programs in other countries and a need for complementary actions for those who are not covered. Programs that offer temporary publically supported employment may complement traditional unemployment insurance or unemployment insurance savings accounts. Programs for temporary employment are relatively common in the region (larger in Chile and Mexico but also present in Bolivia and Peru as well as nascent in Antigua and Barbuda and the Dominican Republic), but they are small relative to countries in other middle income regions and to the scale of unemployment (Grosh, Bussolo, and Freije 2014).

Youth merit special attention in active labor market policies to prevent long term "scarring" from early experiences of unemployment. Over 18 million youth 15-24 are not in education, employment, or training (NEETs, also referred to as "Ninis" in Latin America).[7] Among those youth who are employed, informality is 40 percent higher than among the overall population. At 20 percent, the rate of Latin American and Caribbean youth who are NEETs is not out of line with the rates found in other developing regions (De Hoyos, Rogers, and Szekely 2015).[8] However, addressing the issue is a strongly felt social need, especially in countries experiencing high rates of crime and violence linked to gang activity. Among the reasons that youth inactivity and unemployment merit special attention is that it can be 'scarring', resulting in lower employment and earnings rates for life.[9] In 2008/9 global financial crisis youth suffered higher increases in unemployment than other age groups. In Mexico for example, the youth unemployment rate rose by 3.5 percentage point, while that for prime-age adults by 1.8 percentage points. Similar trends were seen in Argentina, Brazil, Chile, Colombia and Ecuador. So, though something like swimming against the current, high caliber youth employment programs may be especially timely in a downturn to prevent long term losses (Grosh, Bussolo, and Freije 2014).

7 NEET is the most widely used term, adopted by many countries as well as the Organization for Economic Co-operation and Development (OECD). The common Spanish equivalent "NiNis" or "Ninis" derives from "ni estudia, ni trabaja" ("neither studies nor works").

8 Youth who are out of school and out of work constitute 20 percent of the youth population globally, 11 percent in high-income countries, 17 percent in Europe and Central Asia, and 32 percent in the Middle East and North Africa. De Hoyos, Rogers, and Szekely 2015.

9 Székely and Karver (2015) find that for any given cohort of male youth ages 15 to 20, a 1 percent increase in the proportion of ninis predicts a 7 percent reduction in earnings for that cohort d 20 years later. The "scarring" of ninis on women's wages is somehow lower, at 3 percent, but women too suffer significant long-term effects: their likelihood of being employed at age 35-40 falls by half of a percentage point by the experience of being ninis during their adolescence.

Latin America and the Caribbean has been an incubator for comprehensive, multifaceted youth employment programs and evaluation evidence shows these programs are a strong platform on which to expand. The greatest benefits seem to come from initiatives that provide a range of support, including training in technical skills but also socio-emotional skills and sometimes general cognitive skills, practicums or apprenticeships, and job placement assistance. Stipends paid during training can help defray expenses for transport, lunch, and ideally some opportunity costs, and they are especially important to increase the access of poor youth to these interventions. Similarly, support for child care is necessary to ensure that poor young mothers' can access training and job-search services. To be useful to job-seekers, employment services need to respond to employers' demands labor and skills (Almeida et al. 2012; Gonzáles-Velosa, Ripani, and Rosas-Shady 2012). In addition, entrepreneurship programs can assist workers with limited prospects of achieving formal dependent employment. Entrepreneurship support is more effective when it includes training and support to strengthen business skills as well as access to appropriate credit and other financial services (Cho and Honorati 2013).

Governments are already expanding, and refining these programs, anticipating a need to scale up. For example, in Argentina, the Jóvenes con Más y Mejor Trabajo program is operating at large scale. It provides the full range of support to youth, such as labor market orientation, soft-skills training, completion of secondary schooling or technical training, and supporting stipends and job search assistance. In Bolivia, the much younger and smaller program Mi Primer Empleo Digno is set to expand following a successful pilot implementation phase that provided remedial education and training in industrial sewing, metalworking, and construction of housing units to young school dropouts. The program aims to insert unemployed young people into the labor market or foster entrepreneurship among them.

2.2 Finding fiscal savings in reforms to large and regressive social policies;

On average, the region's spending on social protection is in line with international comparators. And evidence suggests that programs in Latin America and the Caribbean have, on the whole, a good track record for effectiveness. However, consideration of how to finance the broadening social contract is important, as is searching for ways to improve effectiveness. Concerns about slowing and low growth and decreased fiscal space are rising, making politically challenging reform of expensive and regressive parts of social policy urgent. There is technical consensus that energy subsidies are regressive and damaging. Social protection tools can facilitate the design of compensatory packages to help governments repeal these programs, which could result in significant fiscal savings. Furthermore, spending on unbalanced contributory pension plans is of particular concern for three reasons: (i) contributory pensions are typically the largest single component of social protection spending; (ii) the de-facto mixed model of financing from earmarked taxes and governments' general revenues through the budget creates distortions and work disincentives; and (iii) without changes in key parameters, such as minimum retirement ages and how benefits are indexed, rapid aging will escalate expenditures further. Although direct savings from reforms to social insurance plans would only be had in the medium and longer term, bold moves to contain future commitments can win governments better financing terms from markets. Fiscal savings from improvements to social assistance will be harder to find and smaller, but in a few cases it may be possible to achieve without hampering effectiveness.

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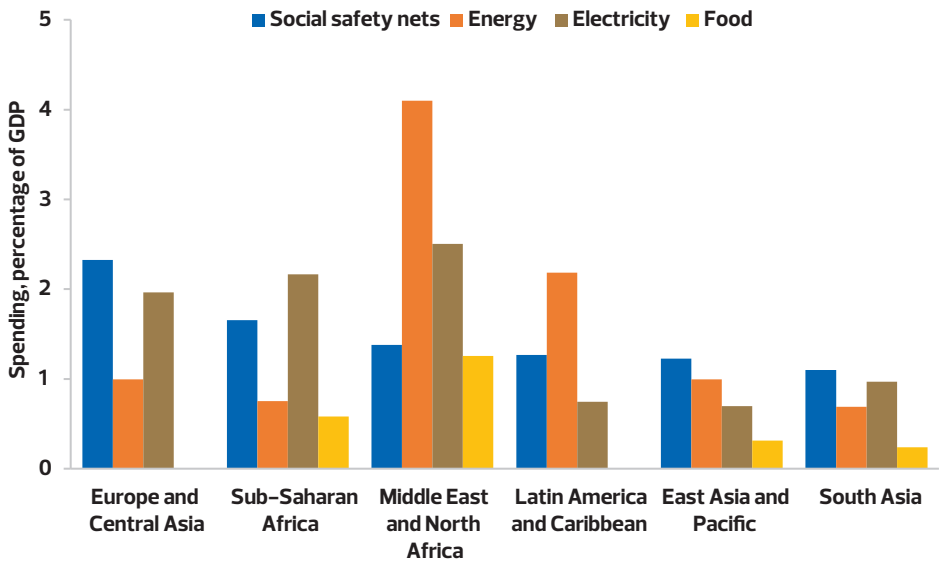
Social protection expenditures in Latin America and the Caribbean are within global norms, albeit often lower than in other regions. Spending to meet the commitments of contributory pension plans is the largest line-item of social protection spending, averaging about 3 percent of GDP in Latin America, albeit with substantial variation—above 6 percent in Argentina, Brazil, and Uruguay but below 1 percent in Guyana, Haiti, and Jamaica (OECD, IDB, and World Bank 2014). By way of context, spending on social assistance programs, as a percentage of GDP, increased threefold over the 2000s, from an average of 0.4 percent among 10 countries in 2000 to 1.2 percent in 2010, though it remains below the world average of 1.6 percent or the OECD average of 2.9 percent.[10] Expenditures on labor market programs—unemployment insurance, employment services, training, wage subsidies, incentives for self-employment, or direct public employment—are much lower, at about 1 percent of GDP in recent years in Brazil and in selected years in Argentina; about 0.3—0.6 percent of GDP in Chile, Colombia; and even lower in the other countries in the regional data.[11] For comparison, the OECD average for unemployment insurance spending alone is in the range of 0.7—1.0 percent of GDP, depending on the year, and average OECD spending on active labor market programs (ALMPs) ranged from 0.5 percent to 0.7 percent of GDP during the 2000s decade.[12] In contrast, ALMP spending in the 10 Eastern and Central European countries was 0.5 percent of GDP in 2008 and 1.0 percent of GDP in 2010 (Kuddo 2012).

In several countries, reductions in regressive energy subsidies may offer governments the fiscal savings they need in the short run for successful public financial management. Spending on energy subsidies by countries in Latin America and the Caribbean is not only the second highest in the world, but several of countries in the region also spend significantly more on energy subsidies than on social safety nets or social assistance. This has become not only a fiscal problem, but an important issue for both energy policy and social policy in the region (figure 7). Energy subsidies exceed 5 percent of GDP in Ecuador and Venezuela (IMF 2013), and energy and transport subsidies exceed 5 percent of GDP in Argentina (World Bank 2015a). In Panama, electricity and liquid propane gas subsidies are far smaller, at 0.75 percent of GDP, but each is still larger than any of the cash transfer programs and larger than social assistance spending (World Bank 2015g). In Honduras, spending on energy subsidies, at 0.5 percent of GDP, is approximately on par with the cost of its CCT program (0.6 percent of GDP) (World Bank 2014).

10 World Bank Latin America and Caribbean SPL Data Base.
11 World Bank Latin America and Caribbean SPL Data Base.
12 OECD UI and ALMP spending averages from OECD iLibrary 3 data, http://www.oecd-ilibrary.org/.

There is growing consensus around the importance of reducing energy subsidies, in order to meet environmental and economic, as well as social policy objectives. G20 leaders have recognized that "inefficient fossil-fuel subsidies encourage wasteful consumption, distort markets, impede investment in clean energy sources and undermine efforts to deal with climate change" and have committed to phase out and rationalize inefficient fossil-fuel subsidies that lead to wasteful consumption "while being conscious of the necessity to provide targeted support to the poorest" (G20 2009, 2013). Moreover, the efficiency and effectiveness of general price subsidies as instruments of social policy are limited for three reasons. First, price subsidies distort the input and consumption choices of firms and households, which can stall the development or adoption of newer, more productive technology. Second, generalized price subsidies are likely to be highly regressive and so to have muted impact on poverty reduction relative to their cost. Third, subsidies crowd out spending available for infrastructure investments and for other social services that not only benefit the poor more directly, but may be urgently needed to put a country on a higher productivity path. Price subsidies are a blunt instrument of social policy developed at a time before governments had the administrative capacity and experience to target assistance to poor and vulnerable households. Now that this capacity and experience is firmly in place in Latin America and the Caribbean they are a costly hold-over, with enormous fiscal weight that are holding countries back.

Figure 7. Global Spending on Subsidies and Social Safety Nets, by Region



Source: World Bank 2015h.
Note: Data on food subsidies not available for all countries.

A few countries have reformed their energy subsidies, and more could take advantage of their social protection system's service delivery tools to do so. The newer social protection instruments are a cheaper, more nimble and effective set of tools. Most Latin American and Caribbean countries now have well-honed social assistance programs as well as the social registries that could serve as means of compensating the repeal of demand-side subsidies as part of an energy reform package, especially when compensation is targeted to the poor. Globally about half of countries that reform energy subsidies provide some sort of social assistance in compensation. Sometimes the assistance is targeted to the poor, other times it is deployed more broadly (IMF 2013). The Latin America and Caribbean's experience is similar. The Dominican Republic in 2010 replaced costly universal subsidies on gas and electricity with targeted subsidies, raised the electricity tariff, and lowered the consumption ceiling below which electricity is subsidized, thus improving targeting of the poor (IADB and World Bank 2013). This reform scenario was made possible by the social registry created for its flagship social assistance programs.

As contributory pensions are the largest component of social protection spending their sustainability is critical to fiscal health. Most countries in Latin America spend approximately 3 percent of GDP on contributory pensions (ILO 2014).[13] But Argentina, Brazil, and Uruguay -countries that are already more "aged" than many in the region and that offer high coverage and generous programs- spend over 6 percent of GDP on contributory pensions (figure 8). Demographic change[14] and the maturing of the systems could lead to much higher expenditures if current policies are unchanged—as high as 9 percent and 13 percent of GDP by 2050 in Uruguay and Argentina, respectively, and 13 and 18 percent by 2100. Of course, pension policy does change over time, but the magnitude of these numbers reinforces the concern about sustainability.

Even taking into account contribution revenue from participating workers and employers, the fiscal burden of contributory pensions is significant. Recent estimates of public pension spending net of contributions using a uniform methodology across a range of countries are not available.[15] However, the few published estimates available from single-country studies illustrate the concern. In Colombia the deficit between spending on contributory pensions and revenue from contributions was 3.8 percent of GDP, and expected to fall as coverage of the Regimen de Prima Media falls but only to 2.1 percent of GDP and not until 2050 (Bosch, et al, 2013). In El Salvador where over 98 percent of people who contribute do so to the new plan of individual accounts, the contribution revenue going to the government is minimal. In 2013 the government spent 2.6 percent of GDP on public pensions, and expected this figure to remain constant until 2030, and then drop to 1.8 percent of GDP (World Bank 2015d). The pensions deficits are not only important for fiscal balance but because they are regressive, financed from general taxes revenues levied in part on families poorer than those with entitlements to social insurance.

13 "Contributory" pensions are those financed by taxes that individuals pay on their own earnings during their working years. "Noncontributory" pensions —also referred to as "social pensions"— consist of cash transfers to individuals targeted on the basis of age and, sometimes poverty if means tested, on income.

14 The region's population is rapidly aging because of two trends: life expectancy has increased dramatically (from 52 years in 1950 to 74 years in 2010, expected to reach 85 years by the end of this century), and fertility rates are declining (from an average of six children per woman in 1950 to two today) (Rofman, Apella, and Vezza 2014). In France, the share of the population over 65-years-old doubled, from 7 percent to 14 percent, over the course of 115 years. In contrast, a similar transformation took 26 years in Chile, 21 years in Brazil, and only 19 years in Colombia. The 25 fastest-aging countries include seven from Latin America: Brazil, Chile, Colombia, Costa Rica, Guatemala, Mexico, and Peru (Kinsella and He 2009).

15 Public spending on social insurance benefits like old-age pensions, survivor and disability benefits, are not strictly comparable to spending on 'non-contributory' social assistance. This is because social insurance is designed to mimic actuarial market insurance and is financed with 'premiums' in the form of ear-marked taxes. When considering the fiscal effort and sustainability of contributory plans, therefore, spending net of revenue from contributions is a better indicator. In Latin America and the Caribbean where several countries have introduced structural changes to social insurance, the contributions of many affiliates now flow in part or entirely into individual retirement savings accounts. This makes calculating public pension spending net of contributions more difficult.

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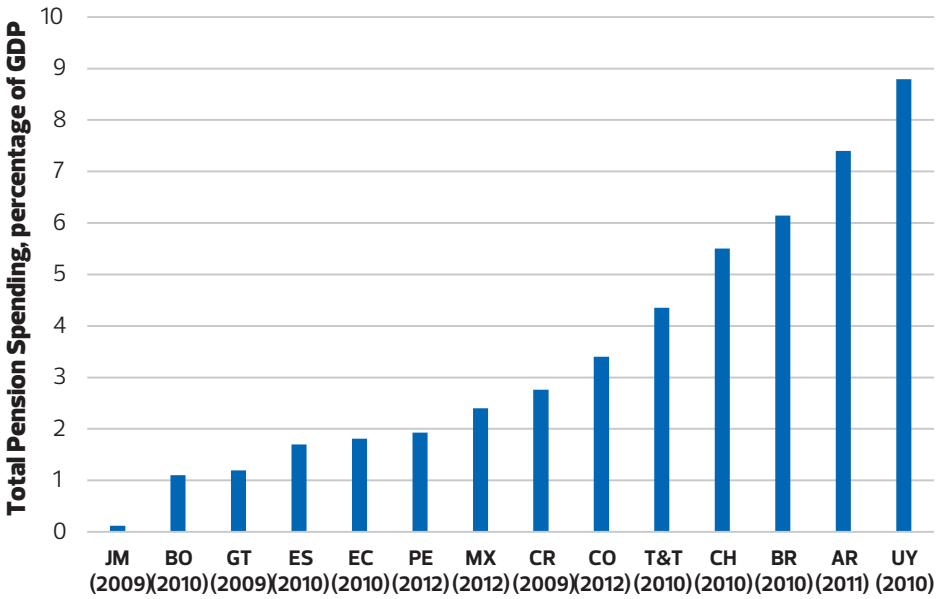
Figure 8. Pension Spending in Latin America and the Caribbean, Selected Countries and Years



Source: World Bank Pension Database (http://go.worldbank.org/IRHX8QBQU0).
Note: As 'contributory' programs are typically financed through earmarked taxes ("contributions") form employers and workers (and sometimes a separate statutory contribution form governments, in addition to those made by government as the employer of civil servants), a more accurate comparison of the fiscal costs of social insurance to spending on social assistance is to spending net of contribution revenue. This statistic is not recently, uniformly available across Latin American and Caribbean countries.
Note: AR=Argentina, BO=Bolivia, BR=Brazil, CL=Chile, CO=Colombia, CR=Costa Rica, EC=Ecuador, ES=El Salvador, GT=Guatemala, JM=Jamaica, MX=Mexico, PE=Peru, T&T=Trinidad and Tobago, UY=Uruguay

More action is needed to address the sustainability of the region's pensions systems. 'Parametric' reforms –changes to contribution rates or to benefit calculations, eligibility parameters or indexing rules– traditionally used to improve actuarial balances contributory pensions –- are always politically contentious and have not been the main focus of pension policy in the region in recent years, though there are some exceptions of governments taking action. Some OECS countries as well as Jamaica have introduced changes in retirement age and contribution ceilings, but for the most part parametric reforms have focused on special plans that cover only particular segments of the labor force (for example, Jamaica's civil service, Trinidad and Tobago's public sector, and the Honduras teachers' scheme), which are more likely than national schemes to suffer from imbalances between commitments and revenue from contributions. More significant adjustments to plan parameters seems likely in coming years as fiscal space narrows and actuarial balances worsen. Even gradual shifts in certain parameters can have significant fiscal pay–offs in time, and although direct savings from reforms to social insurance plans would only be had in the medium and longer term, bold moves to contain future commitments can win governments better financing terms from markets. A few more–innovative approaches to raising formality and thus contributions have been tried and show some promise, as discussed in the next section. And there is room to improve the articulation between contributory and non–contributory pensions in several countries, to reduce the incentive for informal work.

Social assistance budgets offer only a very limited potential for savings as expenditure is already relatively small, but in times of austerity there may be room to improve the impact or modestly trim the budgets of some programs. Overall the coverage of CCT programs has grown in the region since the programs' founding, so that since 2006 the total number of people benefitting has been greater than the number living in extreme poverty as measured by US$2.50/day, and by 2010 equal to the number living in poverty as measured by US$4.0/day. Because targeting is imperfect, coverage of poor households is on the order of 50–60 percent in countries with large programs such as Brazil, Colombia, Ecuador and Mexico (Stampini and Tornarolli, 2012). In some such as Brazil, Ecuador and Mexico, the benefit levels have also grown substantially as well (Levy and Schady, 2013). In some cases such expansions may be in accordance with the progressive realization of goals toward well suited coverage and benefit levels, in others the size or generosity may have crept to levels that could be trimmed a bit. The coverage and benefits of social pension programs are even more prone to increase over time because they less often has a technical formula for updating benefit levels and target groups. The Panamanian program moving from "100 a los 70" to "120 a los 65" puts into the program name the sort of expansions that have been seen around the world with social pensions, with similar examples in Bolivia, Ecuador, and Mexico (see Bosch et al, 2015 and Rofman et al. 2014). Moreover the targeting of social assistance programs in the region, while progressive and in line with world experience, is nonetheless imperfect (see Cerutti et al, 2014) and attention to updating targeting, refining targeting mechanisms or targeting more narrowly may be warranted in some programs. Thus a case by case review of social assistance programs may find ways to modestly increase impacts and/or shave their budgets.

In the search for fiscal savings, one area that needs to be protected is financing for programs that support equality of opportunity among children, which across the region is still troublingly low. Early childhood affords a crucial window of opportunity to address inequality and the life course of the next generation. Recent analysis provides new evidence of the sharp differences in cognitive development between children in Latin America's poorest and its richest quintiles, which affects their ability to learn and eventually to earn. In most cases, differences in wealth accounted for 75–86 percent of this difference in cognitive development (Schady et al. 2014).[16] The substantial gaps highlight the magnitude of the challenge and the importance of developing policies that can help reduce this gap in development outcomes. In particular, chronic malnutrition in childhood—which is well known to cause deficits in cognition, school readiness, health, and future income—is too high in some countries, regions, or groups, most notably: 48 percent in Guatemala;[17] 31 percent in the state of Chiapas, Mexico;[18] and 29 percent in rural areas of Peru.[19] Programs to address nutrition and child development are usually multi-sectoral and social protection systems often play the role of delivery platform in providing income support and in identifying poor children who may be most in need of services.

2.3 Fielding labor markets initiatives to prepare for economic recovery

Along with the slowdown and long period of low growth, other pressures on the demand for labor are making themselves felt. Rapid technological and demographic change are reshaping the labor market. In reaction to institutions that can adapt only slowly to these changes, economic informality is likely

16 To cite only a few, differences in language development (as measured by TVIP scores) between children of the richest and poorest quartiles are statistically significant and large. In urban Colombia and rural Ecuador, the standard deviations were 1.23 and 1.21, respectively. Standard deviations were larger than 0.75 in the urban and rural areas of all five countries with the exception of rural Colombia.
17 Based on latest available data (2009) from the World Development Indicators Database.
18 Data from Mexico's 2012 National Health and Nutrition Survey
19 Data from Peru's 2013 Demographic and Health Survey.

to grow unless forestalled by changes in social protection and other regulatory and tax policies. To be ready to achieve a higher productive potential, countries in Latin America and the Caribbean will need labor institutions and labor market regulation that support risk-taking, mobility and enterprise.

2.3.a. More mobile labor and human capital

Observed from the labor market, a telling indicator of a middle income trap is stagnant labor and human capital, which constrains creative destruction and the reallocation of labor to the most productive jobs. The prevailing labor institutional and regulatory models assume little labor mobility across geography and between sectors as well as longer employee-employer relationships than the norm in Latin America and the Caribbean. Technology and demography are further challenging the assumptions. Worker protection regulation in Latin America and the Caribbean was initially modeled on the European welfare system with provisions for severance pay and worker health and safety. As a result, generous protections were offered to the relatively small share of the workforce who worked in the public civil service, in state-owned enterprises, or in private regulated employment. In the 1980s and 1990s a wave of labor market reform, launched as part of structural adjustment policies, set out to increase labor market flexibility and keep the rise of wages in check (Stallings and Weller 2001; Heckman and Pages 2004; Vega 2005). According to recent studies, Latin America and Caribbean countries have set labor market regulations in a range where impacts on employment and productivity are modest (Betcherman 2013). But a prolonged period of slower growth saps buoyancy from the labor market, and the rate of technological and demographic change will be felt more sharply than during the recent period of economic growth. These forces could motivate policy maker to search anew for ways to ensure that labor market regulation does not stifle factor mobility, productivity and growth.

Informality has always been high in the region, and without a redefinition of key labor institutions, technological change will raise this further. Digital technologies are shrinking firm sizes and increasing on-demand or free-lance work, reducing the formality of work contracts even among high skilled workers and adding to the different causes of informality in the region (World Bank 2015a). Despite a decline in the last decade, economic informality continues to be a prevalent phenomenon – over 40 percent of workers in the region are informally employed or work in unskilled self-employment [20].

Countries have recently launched a number of innovative initiatives to increase formality, but these efforts have had modest rather than transformative impacts. One approach is to make it more attractive to workers to choose formal contracts by subsidizing (some of) the social insurance contributions of groups who have a hard time moving to formality (such as youth, low-income or self-employed workers). Chile and Costa Rica have been using this approach and seen affiliations or contributions rise. A second approach is to encourage small firms to formalize by simplifying regulations or tax collection – a route taken in Brazil with the SIMPLES program. A third approach, being used by Argentina and Brazil is to increase oversight and inspections in an effort to raise compliance with social insurance contributions. (Bosch, Melguizo, and Pagés 2013). None of these approaches —individually or in concert– has provided a way for countries to substantially or sustainably lower levels of informality. In a new, lower-growth equilibrium, their impact is likely to be even more limited.

20 SEDLAC Statistics

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Countries may scrutinize anew different parts of the labor institutional and regulatory apparatus for solutions that will strike the right balance between protection and encouraging formal employment and enterprise. Achieving such a balance requires change on several fronts, including making formal contracts more flexible, lowering the promises and contribution requirements for key social insurance protections, and support for working people to up-skill and re-skill to meet new market demands.

In sharp contrast to the 'flexicurity' movement of labor reforms across Europe, employment protection regulations in most of Latin America and the Caribbean have remained unchanged. Long-standing legal provisions for severance pay are ubiquitous. Overall, Latin America and the Caribbean is in the middle range of generosity internationally regarding severance pay[21], though the administrative requirements in the region tend to be less cumbersome than in other regions. The shortcomings of severance pay are widely known: they depend on the relatively small and inefficient risk pools provided by a single firm; they are not prefunded, and hence insolvent firms might not pay workers; and they can make firms unduly cautious about hiring (Holzmann and Vodopivec 2012). As mentioned previously, the larger, higher-income countries have introduced unemployment insurance (UI) or unemployment insurance savings accounts (UISAs) to overcome some of these problems, but mostly without changing the severance pay regulations that continue to stymie new hiring.

In a long period of low-growth, one area of active interest will be wage policies, including minimum-wage setting, and their impact on productivity and competitiveness. In Brazil, for example, minimum wages have almost doubled since 2002—an important contributor to poverty reduction not only through the increased earnings of minimum-wage workers but also because many social benefits are indexed to changes in the minimum wage. However, such a fast increase raises the question of sustainability. Recent analysis suggests that though its current level (as measured by the share of gross national income per worker or as a share of median or mean wages) is in line with international comparators, the minimum wage in Brazil has grown faster than in most Latin America and Caribbean countries in recent years and, in 2012–13, faster than productivity growth in a third of Brazilian manufacturing firms (Silva, Almeida, and Strokova 2015).

On balance, in financing social protection, Latin America and the Caribbean is moving gradually toward more general revenue-based funding and away from its traditionally high reliance on payroll taxes. The notion that payroll-based financing of social protection perpetuates the divide between formal and informal sectors, has gained momentum in Latin America (Gill, Packard and Yermo 2005; Baeza and Packard 2005; Levy 2008; Ribe, Robalino, and Walker 2012). With the gradual introduction in recent years of significant noncontributory elements in the social protection system (social pensions, subsidized health insurance), the link between a formal job and social protection is being broken, albeit amid plenty of controversy, inconsistencies, and contradictory incentives. Pragmatically, Latin America and the Caribbean countries will continue to combine general revenue and payroll tax-financed elements for years to come. This de-facto 'mixed model' of financing has added distortions and disincentives to historical segmentation that threatens to render labor and human capital stagnant. As growth slows, efforts to minimizing the distortions and disincentives of this reality through careful program design and articulation between programs will become even more important. Although a recovery in growth may be years away, this agenda is key in ensuring working people are ready to be more productive.

21 Benefits for those with five years of service range from a low of five weeks of pay in Belize, Grenada, and Suriname to 21 or more weeks in Argentina, Chile, the Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, and Uruguay.

2.3.b. Encouraging work even among those with low labor force participation or earnings

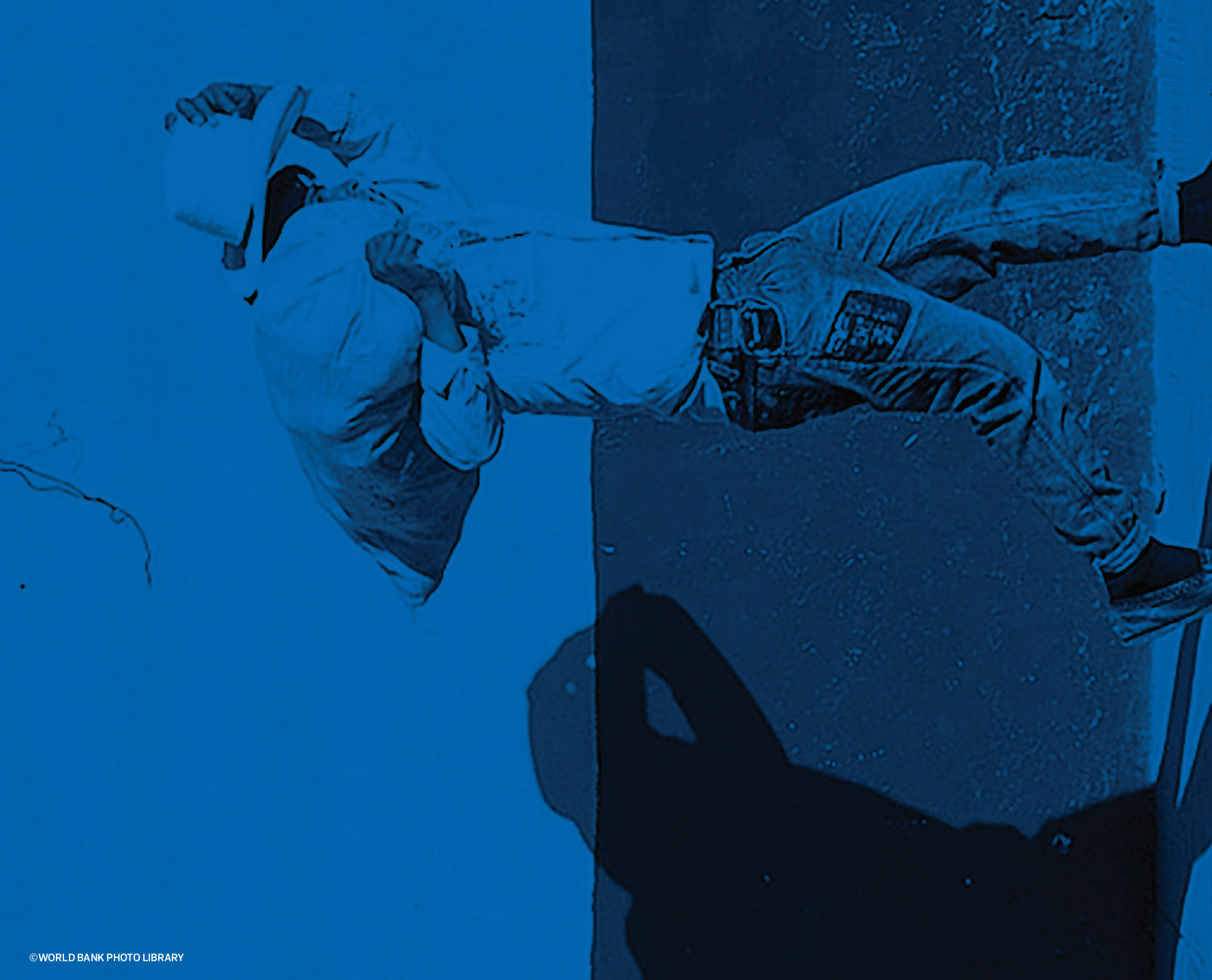
Productive inclusion—ensuring that social assistance beneficiaries have access to additional programs and services that can help to increase their employment or earnings—has been gaining increasing emphasis. As the basic components of income support programs have been solidified, attention is shifting toward finding ways to connect families to complementary means of raising their own incomes. This policy objective is easy to understand but complex to achieve for four reasons. First, the reasons that families have low or volatile incomes are varied, so different families need to be connected to different programs. The needs for support of smallholder agricultural workers, landless agricultural workers, and urban informal or domestic service workers may be very different. Second, as a corollary, the range of programs that may be pertinent is wide and spread across multiple sectors, agencies, and levels of government administration. Third, pertinent programs often lack coverage or may need to be modified to serve the clients of social assistance well. Fourth, the institutional and administrative arrangements to make effective linkages between programs may be missing or nascent. In Jamaica's CCT, Programme of Advancement Through Health and Education (PATH), families go through a recertification process that assigns eligible families to participate in the "Steps to Work" program and receive case management in addition to the cash transfers for two years, after which they leave the program. In Mexico, the CCT program Prospera (previously Oportunidades) recently launched additional social, financial, and productive inclusion components, giving program beneficiaries preferential access to a range of complementary programs meant to support their income-generation capacity. With less favorable labor markets there will be fewer jobs on offer, so it will be harder for the programs to show success. But they may remain a policy favorite if countries are trying to reduce the number of people in receipt of social assistance or unemployment benefits.

Once labor markets tighten, aging countries will want to increase labor force participation rates and may focus on groups where they are low —youth, older workers and women. The problem of youth employment has already received some attention in the region, as discussed above. The issue of how to keep older workers productive and employed has received relatively little attention, in contrast to beginnings in Europe (Schwarz and Arias 2014) and East Asia Pacific (World Bank, 2015f). However, lifelong skills frameworks being developed in Argentina and Chile may help. Labor force participation of workers 65 and older in Latin America and the Caribbean—at just over 20 percent—is an intermediate level in global terms.[22] Women's labor force participation has shown strong secular growth (as it has around the world), but at 50 percent, it remains lower than the men's rate and lower than the women's rate in Europe or East Asia. It is especially low (about 40 percent) in the Dominican Republic and Honduras but higher (about 60 percent) in Bolivia, Peru, and Uruguay (Pagés, Pierre, and Scarpetta 2009, figure 2.8). Multifaceted labor activation policies may help to raise the participation rates and earnings of potential workers in these groups.

2.4 Keeping the Long Run View while Managing the Short Run Adjustment Demands

Social protection is an integral and permanent part of government poverty reduction and risk management strategies. The region's experience in the wake of financial, fiscal and economic crisis during the 1980s and 1990s shows social protection as a foundation of public policy, as have the gains in poverty and equity during the recent years of high growth. Social protection systems mitigate extreme poverty through redistribution of resources, help households manage risks and invest in their futures, and can support employment and productivity. In short, they are an essential element of the social contract.

22 The region's labor force participation among the elderly is about double that in high-income OECD or Eastern European countries, and on rough par with the Middle East and North Africa and East Asia, but well below that in South Asia or Africa (Pallares-Miralles, Romero, and Whitehouse 2012)



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Social protection systems should support individuals and families over the life cycle and across the welfare spectrum. Individually and collectively the programs should be appropriate to context, adequate, cost-effective, equitable, incentive compatible, sustainable and dynamic. These systems are composed of a variety of programs for different age groups and risk profiles, ranging from income support and programs to ensure adequate nutrition for poor infants to voluntary retirement schemes that ensure consumption smoothing for the formerly high income elderly. The overall elements in the system need to be comprehensive and balanced. And because individuals' and families' needs are different and change over time, they must be able to quickly find their way to the appropriate segment of the system. Achieving these features of a social protection system requires careful planning and institutional coordination, and should be supported by the development of administrative tools for cross-program coordination. A systems approach is crucial to improve responsiveness to crises, effectiveness at combating poverty, and the promotion of opportunities through improved human capital, better jobs and higher productivity.[23]

Despite the progress in building social protection systems in the region in recent years, there is still much to do. Poverty is still high in some countries, and in sub-national regions in others. Chronic poverty and social exclusion persist among some groups, especially the indigenous, rural and disabled. At the same time the rising middle class creates demands for more insurance-type programs. Persistent informality, technological and demographic change challenge the current systems of social protection and labor regulation. Even climate change adds demands for disaster relief and support to those who need to change their livelihoods. And while there is a strong base on which to build, there is room for improvements to the parameters or functioning of individual programs and the balance among them.

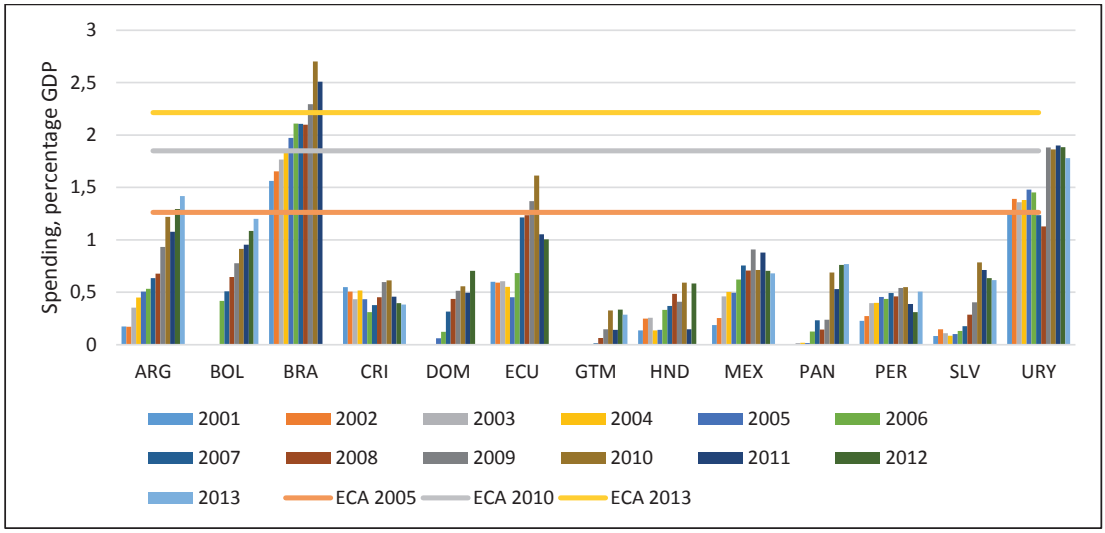
As the region enters a period of lower economic growth, fiscal sustainability and efficiency will rise in importance on the policy agenda. In good macro-fiscal times, countries often focus on increasing coverage and addressing social inclusion, fairness, and human rights concerns while also focusing on improving implementation. When resources are scarce, however, considerations of cost-effectiveness and sustainability gain prominence in addition to long-standing issues such as informal economic activity and competitiveness.

The same downturn that can sap fiscal resources can also spur innovation and reforms that move countries toward better serving social protection systems in the longer run. In fact, past crises gave rise to the creation and expansion of many social protection programs in Latin America and the Caribbean, now seen as part of the basic provisions. On the social assistance side, countries now face the inherent tensions of assisting the poor to get through hard times while also ensuring fiscal sustainability. Fiscal crisis can facilitate difficult actions such as subsidy reform. On the side of labor regulation, it becomes even more important to get the balance between protection and incentives right, to spur individuals' enterprise, and to help promote employment and productivity. Despite country specific differences, improving individual programs to guarantee their effectiveness remains at the heart of the social protection and labor agendas.

23 World Bank, 2012

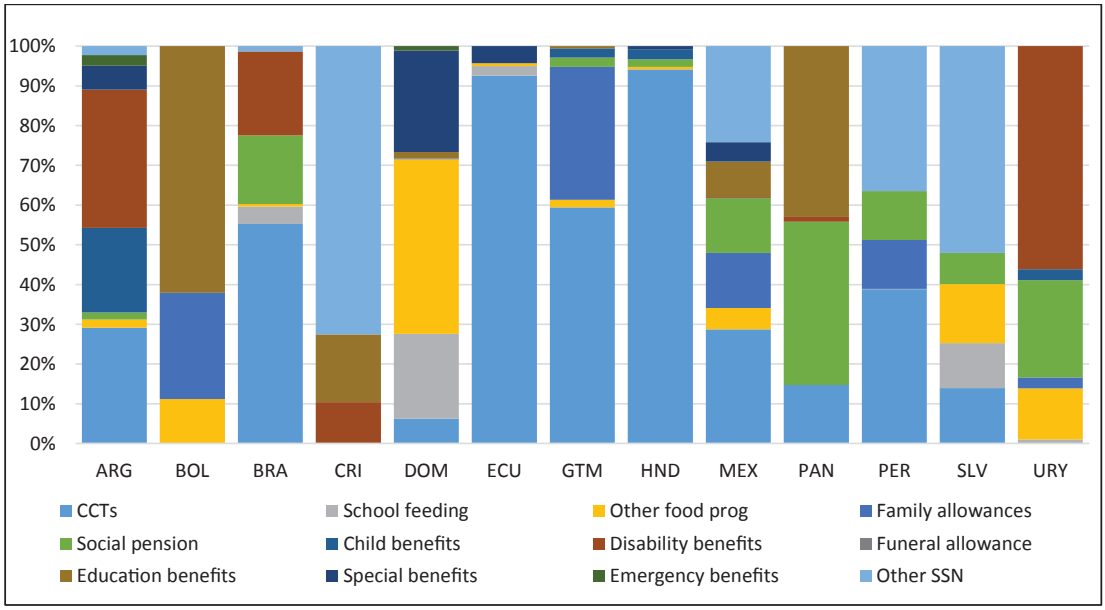
Annex — Spending on Social Assistance and Labor Market Programs

Figure A1.1. Social Assistance Spending (% of GDP), Latin America and the Caribbean



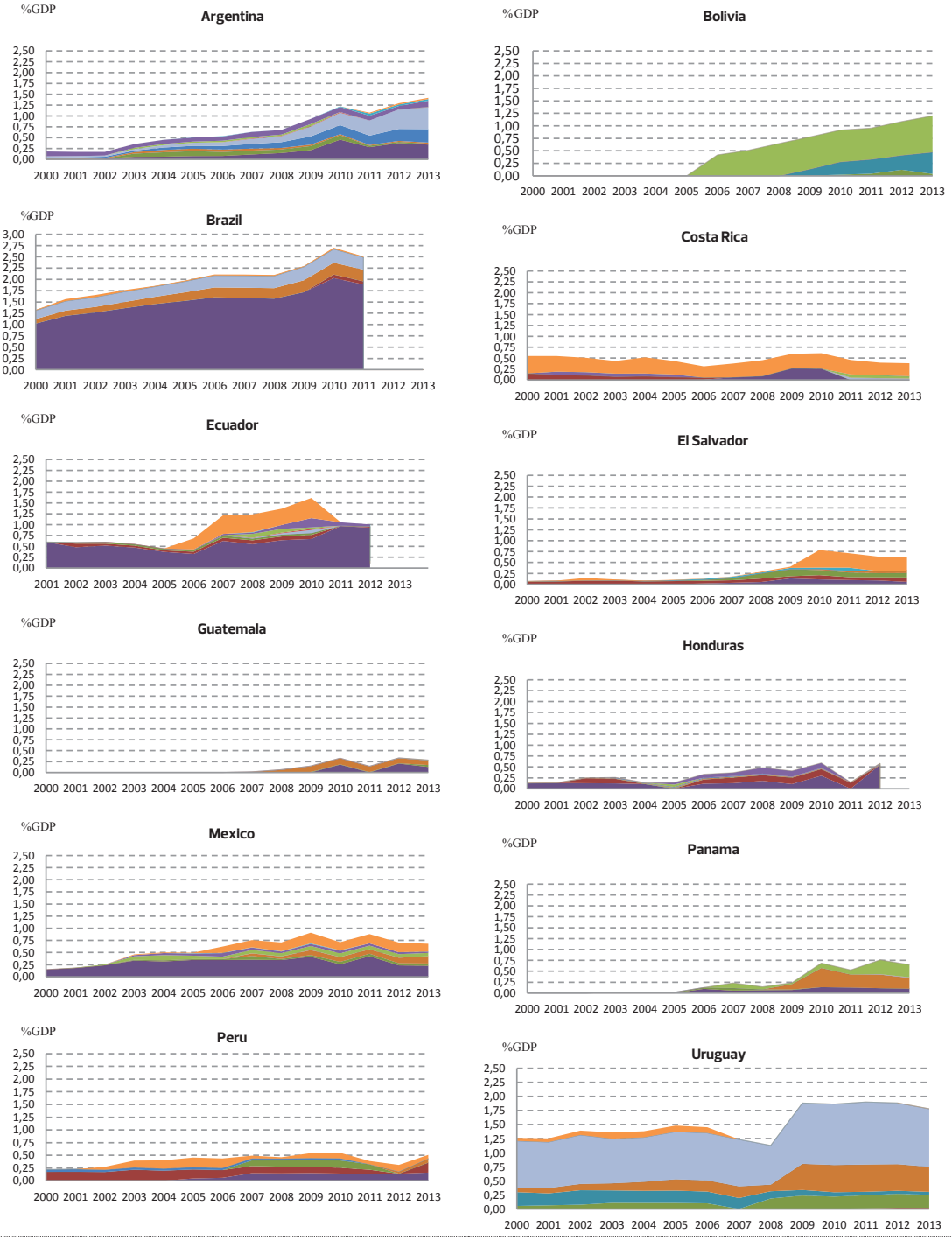
Source: World Bank LAC SP Database
Note: Ecuador, Honduras up to 2012. Brazil up to 2011.

Figure A1.2. Social Assistance Programs, Spending Composition 2012, Latin America and the Caribbean



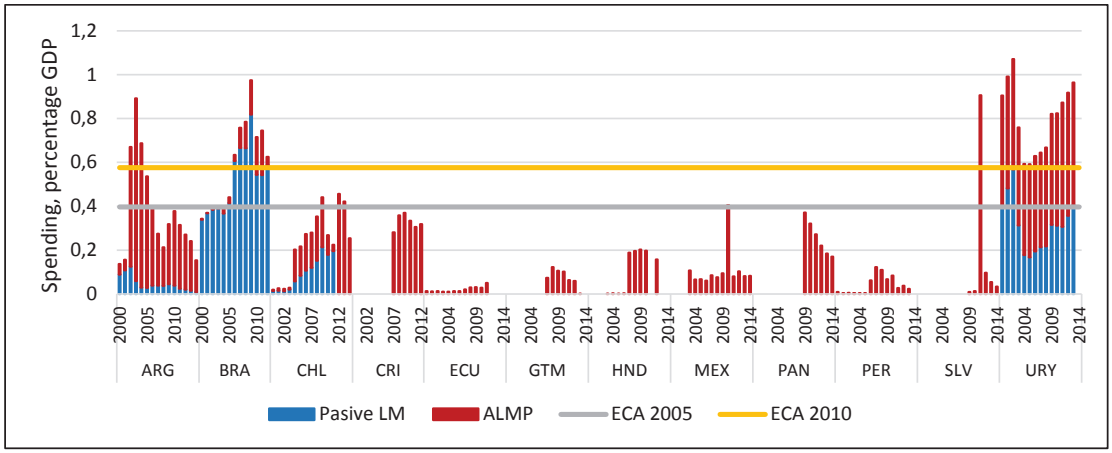
Source: World Bank LAC SP Database
Note: Brazil 2011

Figure A1.3. Social Assistance Spending Composition by Country, 2000–2013



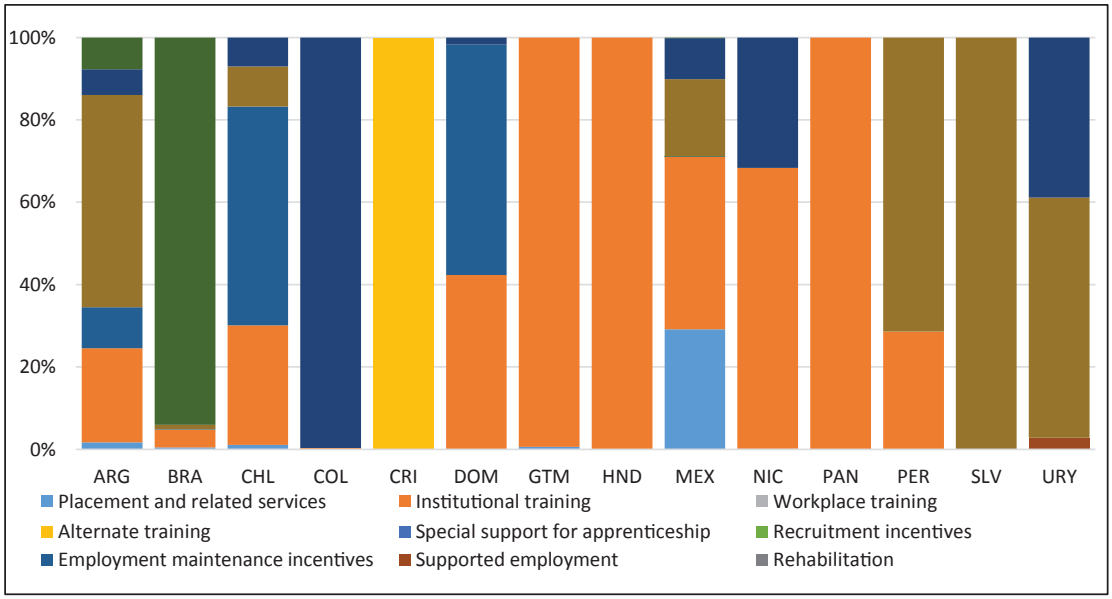
Source: World Bank LAC SP Database
Note: Ecuador, Honduras up to 2012. Brazil up to 2011.

Figure A1.4. Active and Passive Labor Market Programs Spending (% of GDP), Latin America and Caribbean



Source: World Bank LAC SP Database

Figure A1.5. Labor Market Programs, Spending Composition 2012, Latin America and the Caribbean



Source: World Bank LAC SP Database

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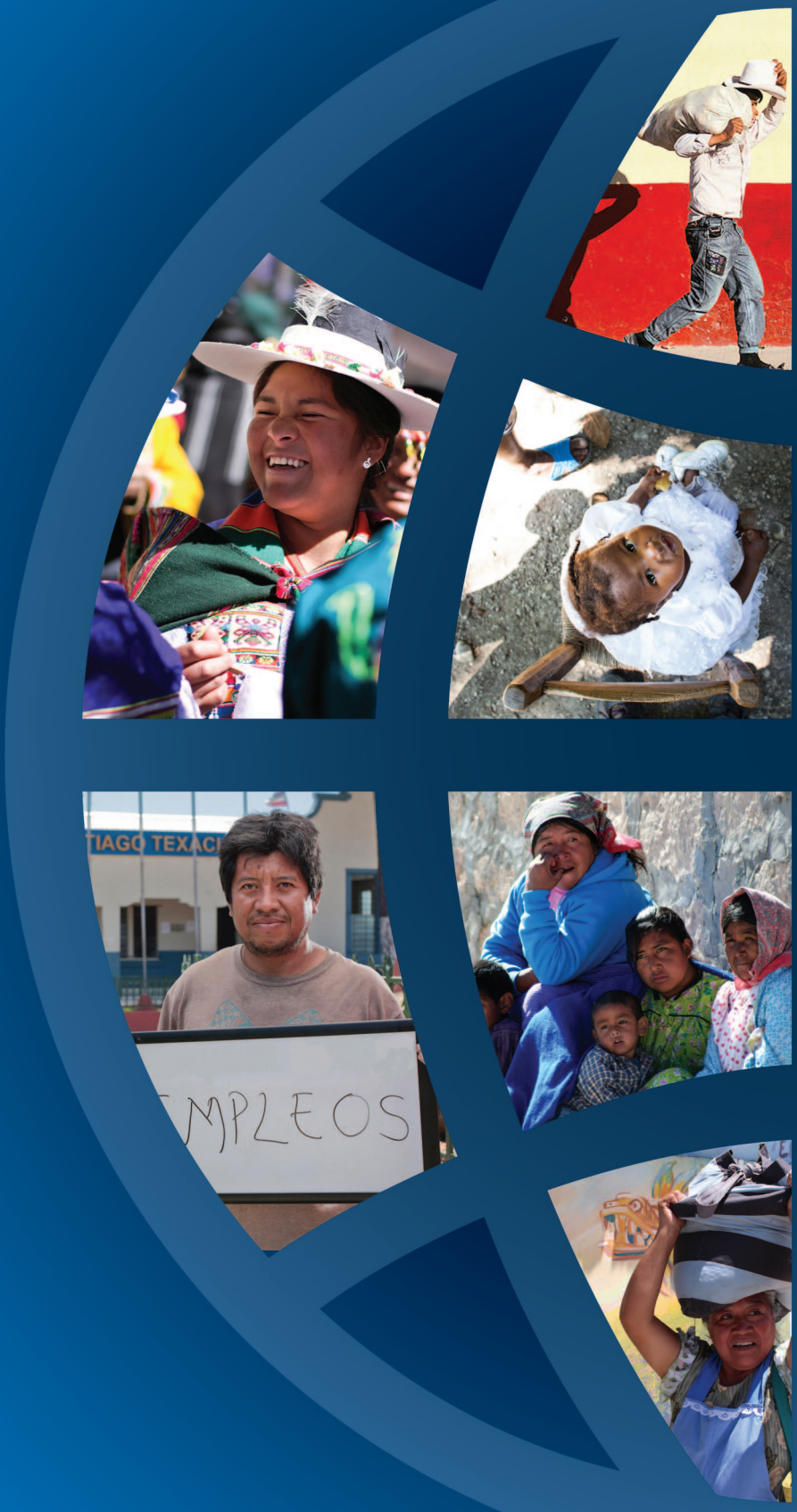
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