Chapter 2

The Labour Market Effects of Social Protection Systems in Emerging Economies

This chapter looks at the labour market effects of three major components of social protection systems in key emerging economies. Country studies are used to examine the case of unemployment compensation in Brazil, cash transfers in South Africa and health protection in Mexico. The findings suggest that extending social protection coverage can, if well-designed, contribute to improved labour market outcomes. Poorly designed systems can weaken the incentives to work and impede the development of formal employment. To ensure positive outcomes, countries should consider: targeting income support policies to those who need it most; better integrating programmes and policies; and promoting self-insurance among those who can afford it.
Key findings

One important challenge for emerging economies in developing adequate social protection systems is to ensure that these systems do not weaken work incentives nor create obstacles to the development of formal employment. Potential trade-offs between social and employment policy objectives also exist in more advanced economies, but this chapter suggests that they tend to take a different form in emerging economies: they tend to be less pronounced in the context of social assistance, but more pronounced in the context of social insurance. In both cases, these differences derive to a large extent from weak administrative capacity.

In the case of social assistance benefits (e.g. such as cash transfers that do not require social security contributions for eligibility), the chapter presents new evidence from the Old-Age Pension and Child Support Grant in South Africa. It finds that these programmes have little adverse impact on labour market outcomes of recipient households. There are a number of reasons for this: cash transfers in emerging countries are usually not conditional on labour force status (unsurprisingly, given the high rate of in-work poverty); due to administrative constraints, the means-tests benefit eligibility are often loosely and irregularly applied, implying that additional income from work is not taxed away as a result of benefit withdrawal; and levels of transfer are usually low relative to household income. As a result, the implicit tax of cash transfers on working tends to be rather low in emerging economies.

In the case of social insurance programmes, however, weak administrative capacity and widespread informal employment may lead to a number of problems. In the case of unemployment insurance (UI), for example, the condition that one must not formally work to be eligible for benefits provides potentially strong incentives to simultaneously receive benefits and work in the informal sector. This may be important, for example, in the case of Brazil. Moreover, workers who can choose between formal and informal work, and who do not perceive the potential benefits of social insurance as outweighing their costs in terms of contributions, may in effect opt out of mandatory social insurance programmes by taking up informal work. Not only can this be detrimental to workers’ well being in the longer term, but by reducing the number of contributors to social protection systems, it also has potentially deleterious consequences for economic growth and risk pooling. However, the extension of health coverage in Mexico through the establishment of a new non-contributory system, Seguro Popular, suggests that this does not necessarily have to be the case in practice. There appears to be essentially no relationship between the gradual geographical roll-out of Seguro Popular and the incidence of informal work, except perhaps for those workers with the highest propensity of moving between informal and formal work.

The cost-effectiveness of social protection programmes can be enhanced through the adoption of innovative programme designs that take account of the potential labour market effects of social protection. Three recommendations are put forward in the chapter to achieve this.
2. THE LABOUR MARKET EFFECTS OF SOCIAL PROTECTION SYSTEMS IN EMERGING ECONOMIES

- Target income support policies to those who need it most. This is not only important from a social policy perspective, but can also help in achieving better labour market outcomes. Given the high incidence of poverty and the limited availability of private insurance, liquidity constraints are likely to provide a major obstacle to making optimal labour market choices in emerging economies. Providing cash-on-hand to those who need it most could increase labour force participation and reduce labour market mismatch, thus making a potentially important contribution to economic growth. For example, the South African Child Support Grant appears to have a more favourable impact on the labour market outcomes of very poor beneficiaries than on less poor ones, presumably because cash transfers allow them to engage in more effective job search. Moreover, evidence from Brazil suggests that providing income support to job losers in the form of unemployment benefits or severance pay reduces the pressure on them to accept job offers that involve large adjustment costs or do not match their qualifications, particularly for those facing tight liquidity constraints.

- Unify separate programmes or combine different policies under a common umbrella. This can help to improve the cost-effectiveness of social protection systems. More integrated programmes reduce administrative costs and in the case of social insurance increase the ability of governments to pool risk, making social protection more affordable. The creation of non-contributory programmes alongside existing contributory programmes enhances social protection coverage, notably for health, but may discourage working formally. This is less likely to be the case if the non-contributory programme is designed in a way that allows a smooth transition towards the contributory programme. This can be done through means-tested fees with a subsidy component which decreases with income. Moreover, policies should seek to go beyond the alleviation of hardship by integrating income support policies with policies to assist beneficiaries in their job search or to help them overcome social problems (e.g. the anti-poverty programme Chile Solidario).

- Increase the use of mandatory self-insurance based on individual savings accounts for those who can afford it, while ensuring that some form of income support is available for those with insufficient savings. The Chilean unemployment insurance system of individual unemployment savings accounts (Régimen de Seguro de Cesantía) in combination with a Solidarity Fund (Fondo de Cesantía Solidario) provides an example of this type of arrangement. Self-insurance provides good incentives for workers to stay employed or return to work when unemployed, while possibly increasing the incentives to work in the formal sector. This may free up resources that could be used to help those with insufficient savings.

These OECD recommendations are in line with the UN’s Social Protection Floor initiative which seeks to promote access to at least minimum levels of social protection for all. As suggested in this chapter, providing access to minimum standards is not just important from an equity perspective but, if well-designed, can also contribute to better labour market outcomes and ultimately stronger and fairer growth.

Introduction

Strengthening social protection systems is a key policy priority in emerging economies. These systems have an essential role to play in addressing persistent poverty, protecting households against income and health-related risks and tackling income inequality. The global crisis of 2008-09 provided a further impetus to develop effective...
social protection systems in emerging economies. It revealed that having social protection systems in place before a crisis strengthens the effectiveness of social policy responses to changing needs. It also highlighted numerous structural vulnerabilities in the social protection systems of emerging economies (OECD, 2010a).3

The development of adequate social protection systems in emerging economies involves some major challenges. The first is to ensure that social protection systems provide adequate support to those who need it in a context of limited fiscal resources and weak administration and a high rate of informal work that leaves large parts of the workforce uncovered by the main instruments of social policy. A second challenge is to ensure that social protection systems do not reduce incentives for work, particularly in the formal sector. Indeed, the concentration of vulnerable households in the informal economy creates potentially difficult trade-offs between social and employment policy objectives. Taking account of the potential labour market effects in the design of social protection systems can make a major contribution to their cost-effectiveness.

This chapter focuses on the trade-offs and possible synergies between employment and social policy objectives that governments in emerging economies are confronting when developing or reforming their social protection systems. A full analysis of these trade-offs and synergies requires analysing the impacts of social protection systems on poverty, income and consumption volatility and income inequality, and the potential impacts on labour markets. This chapter focuses on the potential labour market effects, including reduced work incentives, particularly in the formal sector, and changes in job quality. It covers nine key emerging economies: three OECD members (Chile, Mexico, Turkey), five enhanced-engagement partners (Brazil, China, India, Indonesia, South Africa) and one economy seeking to join the OECD (the Russian Federation).4

Section 1 provides a brief overview of the size and coverage of social protection systems in emerging economies. The rest of the chapter is divided into three Parts, each concentrating on one specific component of social protection and its consequences for labour markets. Part A focuses on the role of unemployment compensation systems for formal-sector job losers, and in particular severance pay and unemployment insurance. New evidence is presented for Brazil, a particularly interesting case due to the relative generosity of its unemployment compensation system and its rich institutional set-up. Part B provides a detailed discussion of the way social assistance may discourage labour market participation or on the contrary help households receiving benefits to overcome barriers to work. New evidence is presented for South Africa, which has a relatively comprehensive and generous system of cash transfers. Part C concentrates on the extension of health protection coverage in countries with national health systems based on contributory and non-contributory components and the potential implications for informal employment. New evidence is presented for Mexico, which increased its health coverage spectacularly during the past decade thanks to the establishment of a non-contributory system, Seguro Popular.

1. Social protection and labour markets in emerging economies

Social protection is generally much lower in emerging economies...

Social protection in emerging economies is generally much weaker than in most OECD countries, leaving an important share of the population vulnerable to poverty, economic shocks and natural and other disasters. Total public social expenditure remains limited in
the emerging economies, well below the OECD average of almost 20% of GDP (Figure 2.1). However, marked differences exist across the emerging economies considered in this chapter. Social spending is highest in Brazil and Russia, where it represents about three quarters of the OECD average, whereas it is three to four times lower than the OECD average in China, India and Mexico. Contributory social insurance programmes account for the bulk of public social expenditure in most emerging countries, but particularly in China, India and Indonesia (OECD, 2010a). Non-contributory social assistance remains limited, despite increases over the past decade. It is most important in South Africa (4.4% of GDP), a country with a comprehensive system of social grants.

Figure 2.1. **Public social expenditure tends to be low in emerging economies**  
Total public expenditure, latest year\(^a,b\)

<table>
<thead>
<tr>
<th>% of GDP</th>
<th>Advanced economies</th>
<th>Emerging economies</th>
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<tbody>
<tr>
<td>30</td>
<td></td>
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\(a\) Latest year refers to 2005 for Brazil, 2006-07 for India and South Africa, 2008 for China.

\(b\) Policy areas covered include old-age, survivors, incapacity-related benefits, family, health, active labour market policies, unemployment, housing.

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... but has increased in recent years

Compared with most OECD countries, coverage of contributory social insurance programmes remains relatively low. The share of the workforce contributing to a pension plan and/or health insurance ranges from about one in ten in India and Indonesia, to about one in three in China and Mexico and between half and two-thirds in the remaining emerging economies with available data (Figure 2.2).\(^5,6\) Some countries have managed to increase substantially the coverage of contributory programmes over the past decades,\(^7\) while others, including India, Chile and Mexico have seen only limited progress (Panel A). In part, low coverage reflects the high incidence of informality and self-employment. While workers in informal employment cannot be affiliated to social security, it is not always compulsory for the self-employed, and when it is, it tends to be difficult to enforce. The share of self-employed in total employment is around 40% in Indonesia and between 20 and 30% in most of the other emerging economies, well above the average OECD share of about 15% (see Annex 2.A2 in OECD, 2011b for details). Moreover, coverage of contributory programmes is concentrated among better-off workers. The coverage gap between workers in the upper quintile and those in the bottom quintile is generally very
large, ranging from 33 percentage points in Chile to 72 percentage points in Brazil (Panel B). Extending coverage represents a major policy objective.

In parallel with the increase in coverage of contributory programmes in some countries, most emerging economies have also experienced a substantial increase in the importance of non-contributory programmes. This reflects, amongst others, the expansion of (conditional) cash-transfer programmes and the development of health-assistance programmes. Cash transfers represent an important component of income for poor households. They account for 58% of household income for the lowest income quintile in South Africa, about 20% in Chile and Mexico and almost 15% in Brazil (Figure 2.3, Panel A). However, this does not necessarily mean that cash transfers are well targeted because it does not take account of differences in income levels across households. Figure 2.3, Panel B, shows that in the three Latin-American economies, the largest part of expenditure on cash transfers goes to the bottom quintile (over 30%), while in South Africa over 35% of cash transfers go to the second lowest quintile and just about 20% to the bottom quintile. In general, the share of cash transfers going to the top quintile tends to be very small.

**Social protection may have important implications for labour market outcomes**

The remainder of this chapter focuses on three major components of social protection systems: unemployment compensation (Part A, Sections 2 to 4), cash transfers (Part B, Sections 5 to 7) and health care (Part C, Sections 8 to 10). These programmes are primarily intended to deal with social policy objectives, but may also have important implications for labour market outcomes. These may be either positive or negative:

- On the positive side, the main impact of social protection is likely to follow from its potential to alleviate liquidity constraints. Liquidity constraints may affect labour market outcomes in different ways. By relaxing liquidity constraints of very poor individuals, cash

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**Figure 2.2. Coverage of social insurance remains limited, especially among the most vulnerable**

A. Affiliation to social security by year

| Year | Chile | Zambia | Brazil | Turkey | Mexico | China | India | Indonesia
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<tr>
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<tbody>
<tr>
<td>1995</td>
<td>60</td>
<td>30</td>
<td>40</td>
<td>20</td>
<td>30</td>
<td>20</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>2000</td>
<td>50</td>
<td>40</td>
<td>60</td>
<td>30</td>
<td>40</td>
<td>30</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>Latest year</td>
<td>40</td>
<td>30</td>
<td>50</td>
<td>20</td>
<td>40</td>
<td>30</td>
<td>20</td>
<td>10</td>
</tr>
</tbody>
</table>

B. Affiliation to social security by earnings quintile, latest year

| Quintile | Chile | Zambia | Brazil | Turkey | Mexico | China | India | Indonesia
<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower quintile</td>
<td>20</td>
<td>10</td>
<td>30</td>
<td>10</td>
<td>20</td>
<td>10</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>Upper quintile</td>
<td>80</td>
<td>90</td>
<td>70</td>
<td>90</td>
<td>80</td>
<td>90</td>
<td>95</td>
<td>95</td>
</tr>
<tr>
<td>Average</td>
<td>50</td>
<td>50</td>
<td>60</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>55</td>
<td>55</td>
</tr>
</tbody>
</table>

Note: 1996 instead of 1995 for Chile; 2001 and 2003 instead of 2000 for Brazil and China, respectively; latest year refers to 2006 for India, 2007 for Indonesia and South Africa, 2008 for Brazil, China and Turkey (Panel B), 2009 for Chile, Mexico and Turkey (Panel A).

a) Data refer to salaried workers only.

Source: OECD’s calculations based on various sources (see Annex 2.A4 in OECD, 2011b for details).
transfers may help to improve their means to search for work, thus potentially increasing their labour market participation. Income support to liquidity-constrained job losers may enable households to better smooth their income during the period of unemployment and reduce the pressure to accept job even if it does not match a worker’s skills. Access to affordable health care, moreover, enhances health, particularly among the poor, and consequently, can have a significant impact on their labour market outcomes.

- On the negative side, social protection may affect labour market outcomes through the presence of informational asymmetries in its provision. In the case of cash transfers, these can take the form of moral hazard when income support to the poor reduces incentives for work. Similarly, since unemployment benefits are conditional on not working formally, they may actually increase incentives to work in the informal sector during the period of benefit receipt. The extension of health protection coverage in countries with national health systems based on contributory and non-contributory components may lead to adverse selection. By providing health benefits for free, non-contributory health insurance programmes can undermine the incentives to work in the formal sector and to become a member of contributory health insurance programmes.

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Figure 2.3. Non-contributory programmes are most important for poor households

<table>
<thead>
<tr>
<th>Quintile 1</th>
<th>Quintile 2</th>
<th>Quintile 3</th>
<th>Quintile 4</th>
<th>Quintile 5</th>
</tr>
</thead>
</table>

A. Share of cash transfers in household income by quintile of household income distribution

B. Total public spending on cash transfers by quintile of household income distribution

Note: The following cash transfer programmes are included in the calculations: Brazil: Bolsa Familia, Beneficio Assistencial de Prestação Continuada, PETI, Bolsa Escola, Bolsa Alimentação; Chile: Chile solidario, Pension Basica Solidaria, Aporte Solidario; Mexico: Progresa/Oportunidades and Programa Para Adultos Mayores; South Africa: Child Support Grant, Care Dependency Grant, Disability Grants, Old Age Pension. The years considered are: 2009 for Brazil and Chile, 2008 for Mexico and South Africa.


StatLink: [http://dx.doi.org/10.1787/888932479572](http://dx.doi.org/10.1787/888932479572)
2. THE LABOUR MARKET EFFECTS OF SOCIAL PROTECTION SYSTEMS IN EMERGING ECONOMIES

PART A.
The Impact of Unemployment Compensation Systems on Labour Market Outcomes

Part A concentrates on the two main instruments to protect workers in the case of job loss: severance pay (SP) and unemployment insurance (UI). As SP is only applicable to workers whose employment relationship accords with existing employment regulations and UI to workers who are affiliated to social security, informal workers are excluded from the analysis. Targeted support to informal-sector job losers is rare in emerging economies. The main exception is the Russian Federation which provides unemployment assistance to workers who fail to meet eligibility requirements. In other emerging economies, general social assistance programmes play a potentially important role in alleviating the social costs of unemployment-related poverty for job losers from the informal sector. These are discussed in Part B.

2. Characterising unemployment compensation systems in emerging economies

This section characterises unemployment compensation systems in emerging economies in terms of the existing institutional arrangements with respect to unemployment insurance and severance pay, their relative generosity and their coverage.

Worker and job-oriented systems of income support for job losers

While SP and UI are alternative instruments to provide income support to job losers, there are important differences in the way they protect workers against the risk of unemployment.

● UI represents a worker-oriented approach to income support for job losers as it tends to be modulated to the needs of workers (i.e. being unemployed). The purpose is to alleviate the impact of job loss on consumption during the period of unemployment and to provide workers with the means to search for a suitable job. By contrast, SP represents a job-oriented approach in the sense that it tends to reduce the risk of unemployment directly, through the use of a firing penalty based on the implicit value of job matches (e.g. seniority). By increasing firing costs for employers, SP may help to preserve match-specific human capital by reducing “excessive turnover” of workers whose job matches have temporarily become unprofitable and to strengthen incentives to invest in firm-specific human capital.

● Another important difference between SP and UI is that the latter relies on the pooling of resources across individuals and firms. Pooling across individuals that differ in their labour-market risk reduces the cost of insurance and thus helps to make unemployment protection affordable. The pooling of risk also implies that resources are being redistributed from low-risk to high-risk workers. In the case of SP, the pooling of risk is necessarily restricted to individuals in a given firm, thus limiting its efficiency and its impact on the distribution of income. Traditional UI systems also tend to pool resources across firms that differ in their layoff behaviour. Firms typically contribute according to the level of their payrolls and bear no responsibility for the costs of layoffs to society. As a result, UI represents an implicit subsidy from low-layoff to high-layoff firms. This is undesirable to the extent that it increases excessive layoffs, but is desirable to the extent that risk-taking by firms, for example through the adoption of new technologies or innovation, enhances economic growth (Acemoglu and Shimer, 1999).

In principle, unemployment compensation systems could also take the form of a hybrid between the two traditional approaches to deal with unemployment risk. Individual saving accounts (ISAs) impose mandatory savings that may be accessed when a worker is...
dismissed, as in the case of SP, or during a specified period of unemployment, as in the case of UI. Any savings that are left upon retirement can be converted into a pension or may be withdrawn in their entirety. Similar to traditional SP, ISAs do not allow for the pooling of resources across different groups of workers. Another hybrid system is that of experience-rated UI which combines layoff taxes paid by firms, effectively a form of employment protection, with collective UI. A typology of the different systems is provided in Table 2.1.

Table 2.1. **A typology of unemployment compensation systems in emerging economies**

<table>
<thead>
<tr>
<th>Not redistributive</th>
<th>Income support without firing penalty</th>
<th>Income support plus firing penalty</th>
<th>Income support in form of firing penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td>Individual saving accounts</td>
<td>Individual saving accounts with firing penalty</td>
<td>Traditional severance pay systems based on firing penalty</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Brazil</td>
<td>Chile, China, India, Indonesia, Mexico, Russian Federation, South Africa, Turkey</td>
</tr>
<tr>
<td>Somewhat redistributive</td>
<td>Individual saving account + unemployment insurance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Redistributive</td>
<td>Traditional unemployment insurance</td>
<td>Experience-rated unemployment insurance financed through layoff taxes</td>
<td></td>
</tr>
<tr>
<td>Brazil, China, India, Russian Federation, South Africa, Turkey</td>
<td></td>
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</table>

a) The share of unemployed receiving UI benefits in India is close to zero. Source: OECD Secretariat.

All emerging economies except Brazil have traditional SP systems which impose a firing penalty on employers in the case of unfair dismissal. Brazil has a mixed system that combines ISAs with a firing penalty for employers. Five emerging economies (excluding India where coverage is negligible) have traditional UI systems in place, although pooling is often sub-optimal. Chile has a mixed system that combines individual saving accounts for unemployment with UI to provide support to unemployed job-losers with insufficient savings. Mexico may be considered to have a pure ISA system in the form of an individual pension-accounts system that, in principle, can be used for withdrawals in the case of unemployment under certain conditions.

**Severance pay represents the main form of unemployment compensation in most emerging economies...**

Figure 2.4 juxtaposes the value of income support from SP and UI that is available to eligible job losers in terms of multiples of their previous monthly wage. The comparison is restricted to the maximum value of income support available to eligible job losers with four years of tenure in their last job during the first 12 months of unemployment. The upward-sloping diagonal traces out increasing levels of total unemployment compensation. The downward-sloping diagonal traces out different combinations of SP and UI that sum to the average level of total unemployment compensation in the OECD area (e.g. about five months). Countries above this diagonal have overall compensation that is above the OECD average. To account for systems with individual accounts, broad definitions of SP and UI are...
used: SP refers to lump-sum payments to dismissed workers, whereas UBs refer to (periodic) payments to unemployed workers. The figure provides the following insights:

- In seven out of nine emerging economies, the value of SP for workers unemployed for one year exceeds that of UI, while the value of SP and UI are about the same in the Russian Federation. Only in South Africa is the value of UI substantially higher than that of SP. Moreover, three out of nine emerging economies have no universal UI system, while all have SP systems in place.\(^{16}\) By contrast, in all advanced economies, the value of unemployment benefits available to workers during the first year of unemployment exceeds that of severance pay. Moreover, all advanced countries, have universal UI systems in place, while about half do not have any mandatory SP programmes.\(^{17}\)

- The value of de jure income support available to eligible job losers during the first year of unemployment differs substantially across emerging economies. In Brazil and Turkey, income support is markedly more generous than the OECD average. This reflects a combination of high SP with moderate levels of UI. In India and Mexico, income support is substantially less than the OECD average, with little or no benefits for the unemployed.
... in terms of the value of income support as well as its coverage across job losers

It should be stressed, however, that in practice, the average level of income support available to job losers in emerging economies tends to be much lower because the large majority of them is not eligible to any form of income support. Workers employed in firms that fail to pay social security contributions are necessarily excluded from UI as they do not meet minimum contribution requirements. Moreover, eligible job losers often do not receive severance pay, or the full amount they are entitled to, due to widespread “non-performance”, i.e. the inability or refusal of firms to live up to their severance-pay commitments. For example, in Indonesia only 34% of eligible workers who separated from their jobs in 2008 actually received severance pay and a large majority of them received less than their full entitlement amount (World Bank, 2010a).18 Formal-sector job losers often do not qualify for UI due to strict eligibility requirements or exhaust their benefits before finding a job due their short maximum duration (OECD, 2010a). Eligibility conditions are particularly strict in India where workers should have contributed for at least five years and Turkey where workers should have contributed at least during 20 of the last 36 months. Minimum contribution requirements of one year in China and Chile are also likely to exclude many job losers from unemployment benefits. The short maximum duration of UI limits overall coverage in Brazil and Chile (e.g. up to five months).

Figure 2.5 presents information on UB coverage as measured by the ratio of beneficiaries to the number of unemployed. It shows that benefit-recipiency rates are much lower in emerging economies than in advanced economies. UB recipiency is highest in Brazil, with just over 30%, it ranges between 20 and 25% in Chile and the Russian Federation, and between 10 and 15% in China, South Africa and Turkey. The low level of coverage in emerging economies greatly limits the ability of UI systems to prevent unemployment-related poverty and increases the importance of informal coping mechanisms. It may also impose higher

Figure 2.5. Unemployment benefit recipiency rates
Percentage of total unemployed, 2007/08

a) Data do not include unemployment assistance which exists in case the unemployed do not meet minimum eligibility conditions for UI or have exhausted the right to UI benefits.
b) Includes Jobseeker’s allowance (social insurance and social assistance).
c) Information on data for Israel: http://dx.doi.org/10.1787/888932315602.
Source: ILO Social Security Inquiry Database and national sources for Brazil and Mexico.

StatLink http://dx.doi.org/10.1787/888932479610
adjustment costs for people who return to work and can represent an inefficient use of resources when individuals are credit-constrained.

While internationally comparable data on recipiency rates of SP and UI are not available, it seems plausible that, at least in countries where UBs are conditional on being unemployed involuntarily (Chile is an exception), most job losers who are eligible for UI also qualify for SP, while the share of SP-eligible job losers that also qualifies for UI is likely to be more limited. If this is indeed the case, unemployment support systems in emerging economies place a strong emphasis on SP, not just in terms of the value of income support to eligible workers, but also in terms of coverage.19

Is unemployment insurance a “superior good”?

There are several reasons why unemployment compensation systems in advanced economies rely mainly on UI, while they tend to rely on SP in emerging economies:

● The public provision of UI tends to be more costly in emerging economies due to the presence of widespread informal work and its tendency to reinforce informational problems, i.e. adverse selection and moral hazard.20 Mandatory requirements in emerging economies are unlikely to completely rule out the problem of adverse selection when large parts of the workforce operate outside the reach of the law. Moreover, moral hazard is more difficult to control when unemployment beneficiaries have the possibility of working in the informal sector whilst claiming benefits.21 As a result, the provision of public UI may be very costly in emerging economies. Indeed, employment-protection rules have often been considered a low-cost way of providing social insurance to workers in such economies (Heckman and Pages, 2004).

● The institutional capacity for the effective public provision of UI may be lacking. Providing UI effectively requires, first of all, the sound management of insurance funds. This involves a minimum level of financial-market development, low levels of corruption and the establishment of an institution with a certain degree of political independence. Moreover, the administration of initial and continued benefit eligibility requires a rich multi-level infrastructure, ranging from national labour ministries to local public employment services, with effective coordination between the administration of benefits and the providers of employment services. While this can be a challenge in many advanced economies, it is very difficult to achieve in emerging economies.

3. The impact of unemployment compensation systems on labour market outcomes: A case study for Brazil

This section sheds light on the labour market effects of different unemployment compensation systems in emerging economies. It considers three channels for such effects: i) through its impact on worker turnover; ii) through its impact on unemployment and labour supply; and iii) through its impact on job quality.22 Special emphasis is given to Brazil since this provides a particularly interesting case study of unemployment compensation systems due to the relative generosity of unemployment compensation (see Figure 2.4), its high coverage by emerging-economy standards (see Figure 2.5) and its rich institutional set-up based on the combination of individual severance pay accounts (Fundo de Garantia do Tempo de Serviço) with a system of public unemployment insurance (Seguro Desemprego) (see Box 2.1).
Box 2.1. Unemployment compensation systems in Brazil

Income support to the unemployed in Brazil is restricted to formal workers who are dismissed without just cause and workers who lost their job as their firm closed down. This means that the large majority of unemployed do not have access to unemployment-related benefits, including previously informal workers, labour-market entrants and individuals who quit voluntarily. The system of unemployment compensation consists of two components:

- The Guarantee Fund for Length of Service (Fundo de Garantia do Tempo de Serviço, FGTS) combines mandatory saving accounts with a firing penalty upon unfair dismissal. The FGTS – established in 1967 – represents a fund that can be used for special occasions, including dismissal without just cause; the acquisition of a home; and retirement. Withdrawals in the case of unfair dismissal account for about two-thirds of FGTS expenditure (Caixa Economia Federal, 2009). Every Brazilian worker with a formal employment contract governed by the Brazilian Labour Code (Consolidação das Leis do Trabalho, CLT) is eligible to FGTS. To constitute this fund, the employer deposits 8% of the worker’s monthly earnings into a saving account in the worker’s name (2% for fixed-term workers). Moreover, workers with more than three months of tenure are entitled to an indemnity based on the total amount deposited by the employer in their FGTS account. This indemnity, or firing penalty, was initially set at 10% of the amount deposited, but was increased to 40% in 1988. In 2001, the firing penalty was increased further to 50%, although the indemnity to the worker remained unchanged as the additional 10% is to be paid to the government instead of the employee.

- Universal unemployment insurance (Seguro Desemprego, SD) was established in 1986 as part of the Cruzado plan of macro-economic stabilisation and has operated in the current institutional structure since 1994. Eligibility is restricted to formal-sector job losers in the private sector with at least six months of contributions during the past three years. Unemployment benefits are means-tested. The insured must lack other resources to support herself or her family and must not receive other social insurance benefits. The benefits range from 1 to 1.87 times the minimum wage, depending on the level of previous earnings. The maximum duration of benefits is three months for individuals in a formal job between 6-12 months in the past three years; four months for individuals in a formal job between 12-24 months; and five months for individuals with more than 24 months. Under special conditions, the benefit may be extended for an additional two months. SD is financed by the government through earmarked taxes on businesses. The law that instituted SD also mandated the public employment service (SINE) with the task to help the unemployed back into work.

The table below provides information on the value of income support available for the unemployed under both systems. The average withdrawal from FGTS is about three to four times as high as one monthly payment of SD. The total value of income support available under SD, e.g. five monthly payments, is about 1.7 times as large as that of the average FGTS withdrawal (see Hijzen, 2011, for further details).

| Average values of unemployment benefits and severance payments in selected years |
|---|---|---|
| One month of unemployment benefits | Five months of unemployment benefits | Severance pay (FGTS) |
| % of minimum wage | % of average wage | % of minimum wage | % of average wage | % of minimum wage | % of average wage |
| 2002 | 143 | 46 | 713 | 229 | 551 | 177 |
| 2005 | 136 | 50 | 678 | 252 | 440 | 164 |
| 2008 | 128 | 53 | 640 | 263 | 391 | 161 |
| 2009 | 128 | 55 | 642 | 274 | 387 | 165 |
| 2010 | 126 | .. | 631 | .. | .. | .. |

Source: OECD’s calculations based on SAEG and FGTS (www fgts.gov.br/downloads.asp).

StatLink: [http://dx.doi.org/10.1787/888932480332](http://dx.doi.org/10.1787/888932480332)
Unemployment compensation systems and the risk of unemployment

The primary objective of SP systems is to increase job security through the use of a firing penalty and the existing empirical evidence confirms that severance pay tends to reduce worker turnover (Micco and Pages, 2006; Bassanini et al., 2010). Reducing “excessive” layoffs helps preserving match-specific capital and strengthening incentives to invest in firm-specific skills, but strict employment protection may also have important unintended consequences. It can have adverse consequences for the level of unemployment and employment, the perceived level of worker security and labour market segmentation. Moreover, by locking up workers in unviable jobs, it may become an obstacle to growth and the creation of new jobs.

- Employment protection has no effect or a negative effect on employment. Indeed, most previous cross-country studies for developed countries find no significant impact of employment protection on the level on employment or unemployment (Boeri and Van Ours, 2008, for an overview), while its impact on employment in developing countries tends to be negative (Botero et al., 2004; Heckman and Pages, 2004; Micco and Pages, 2006; Djankov and Ramalho, 2008).
- Stricter employment protection may be associated with lower levels of perceived worker security, while more generous UBs may improve perceived worker security (Clark and Postel-Vinay, 2009). Although employment protection reduces the risk of unemployment, the cost of losing one’s job may be larger in the context of strict employment protection due to its negative impact on hiring. By contrast, UBs reduce the cost of being unemployed.
- Strict employment protection may reinforce labour-market segmentation by concentrating job losses among low-tenured workers, while providing protection to long-tenure workers. Moreover, strict employment protection provides incentives to employers to circumvent firing costs by making greater use of temporary contracts or informal working arrangements. For example, Besley and Burgess (2004) find that increased EP raises employment and output in the informal sector in India.

Unemployment compensation systems based on UI or individual saving accounts do not directly affect the risk of unemployment, but can have indirect effects. By redistributing resources from low-risk to high-risk jobs, standard UI promotes the creation of high-risk high-productivity jobs, increasing job turnover. Alternatively, by helping workers to get jobs that are compatible with their skills, UI can increase match efficiency and reduce worker turnover (Marimom and Zilibotti, 1999). Individual saving accounts may affect worker turnover by creating incentives for workers to induce their own dismissal in order to gain access to their saving account. This problem has been observed in Brazil and to a lesser extent also in Chile. Such incentives are likely to be stronger, the higher are mandated savings and the weaker the confidence in the system. A stable macro-economic environment and well-developed financial sector are likely to be important ingredients for fostering trust in the system (see Box 2.2 for a more detailed discussion).

The impact of unemployment compensation systems on unemployment duration

There exists a large literature that analyses the impact of UI on the duration of unemployment in developed countries. The general reading of this literature is that UI increases the duration of unemployment. First, most studies find a positive and significant elasticity of the duration of unemployment with respect to the level or the maximum duration of benefits. The positive impact of UI on unemployment duration is
Box 2.2. **The role of individual severance saving accounts for worker reallocation**

Individual severance/unemployment saving accounts should have no impact on the hiring and firing decisions of firms. However, individual account systems have sometimes been criticised as they may lead to excessive turnover due to their tendency to create incentives to induce one's own dismissal to gain access to one's saving account.

- **Brazil**, there has been a lively debate on this question related to FGTS. In the past, workers had strong incentives to access their accounts because the amounts involved were considerable and returns to the fund tended to be below market rates and have even been negative. While the presence of a firing penalty should, in principle, have reduced worker turnover, the fact that until 2001 the entire firing penalty was to be paid directly to the worker, left considerable scope for collusive behavior between workers and their firms. However, reforms in the labour code that increased the firing penalty from 10 to 40% in 1998 and the introduction of an explicit layoff tax of 10% payable directly to the government in 2001 are likely to have reduced the scope for workers and firms to collude over dismissals (Barros and Corseuil, 2004; Gonzago, 2003).

- **Colombia** transformed its traditional system of severance pay in 1990 into a system of individual severance accounts. Instead of having to pay one month per year of service at the time of dismissal, employers are mandated to regularly contribute 8.3% of monthly earnings to an individual’s saving account. Since this reform effectively transformed severance pay into a delayed payment, it largely removed the problem of non-performance associated with the original system and increased worker turnover. Kugler (1999) shows that the reform increased flows in and out of unemployment, resulting in a small net reduction in unemployment. The rise in worker turnover is also likely to have contributed to improved job reallocation and higher productivity growth.

typically interpreted as a labour-supply disincetive effect or a moral-hazard effect: by increasing the value of not-working relative to working, UI reduces the marginal benefit of job search and increases the reservation wage. Second, many studies have shown that the exit rate from unemployment exhibits a spike around the time benefits expire. The spike at benefit exhaustion, in principle, suggests that recipients tend to wait until their benefits run out before returning to work. However, there are a number of reasons to suggest that the evidence on the labour-supply disincentives of UI needs to be qualified, particularly in the context of emerging economies.

- The spike around the point of benefit exhaustion may not be as important as sometimes suggested. Card et al. (2007a) argue that the spike has often been exaggerated due to problems with the measurement of transitions from unemployment to work. Based on a survey of the literature and new estimates for Austria, they conclude that the vast majority of job seekers does not wait until their UI benefits are exhausted to return to work. Moreover, moral-hazard effects due to UI receipt are likely to take a somewhat different form in emerging economies, since UI not only increases the value of not working but also that of working in the informal sector. In the context of widespread labour informality and weak enforcement capacity, it is difficult to ensure that individuals do not take up a job in the informal sector whilst receiving UBs. Consequently, the impact of UI on work incentives per se may be weaker in emerging economies.
In contrast to conventional wisdom, a positive association between UI eligibility and the duration of unemployment does not necessarily imply that UI benefits are too generous from a welfare perspective (Chetty, 2008). The welfare implications of UI depend on the extent to which increased duration on unemployment derives from a liquidity (or income) effect, i.e. the reduced need to return to work quickly to limit the impact of job loss on consumption, or a moral-hazard (or substitution) effect, i.e. the reduction in search intensity due to the subsidisation of unproductive leisure. The latter is a socially detrimental response as it fails to take account of the cost of unemployment for society. The former is a socially beneficial response to imperfections in credit and insurance markets, since liquidity constraints may force job losers to accept jobs that involve high adjustment costs (e.g. relocation) or do not correspond to a person’s qualifications and experience, resulting in a loss of human capital. Previous studies for the United States (Chetty, 2008) and Austria (Card et al., 2007a) show that liquidity effects are empirically important, accounting for up to 60% of the marginal effect of UI benefits on the duration of unemployment.26 Given the importance of financial market imperfections and relatively low levels of wealth, one may expect liquidity effects to be particularly important in emerging economies (Chetty and Looney, 2006).

While the discussion above suggests that the unemployment duration effects of UI may differ in important respects in emerging and developed countries, very few empirical studies have analysed the impact of UI on unemployment duration in emerging economies. In an effort to fill this gap, new econometric evidence is presented on the impact of SP and UI on the duration of non-employment for Brazil. The impact of unemployment compensation systems is identified by means of a difference-in-differences approach that exploits the fact that eligibility to SP and UI depends on tenure in the previous job and is restricted to formal-sector job losers (see Box 2.3 for details). The results are summarised in Figure 2.6, while the full results are reported in Hijzen (2011).

Severance pay increases the duration of non-employment. This can be seen in Figure 2.6 by comparing the difference in the job-finding rate due to income support for workers with 24 to 48 months of tenure in their last job with those with more than 48 months of tenure in their last job. While formal-sector job losers with 24 to 48 months in the previous job and those with over 48 months are all eligible for five months of UI, the job-finding rate is significantly lower for formal-sector job losers in the latter group. This difference is attributed to the role of SP in insuring liquidity since SP is estimated to be over three times as large for this group compared with formal-sector job losers with between 24 and 48 months in their previous job. The quantitative difference is relatively large. Hijzen (2011) shows that the probability of returning to work would have been about 1.7 times as high without the difference in severance pay at the start of non-employment. This suggests that liquidity effects are empirically important.

The reduction in the probability of returning to work for workers with less than 48 months of tenure is likely to reflect a combination of liquidity and moral-hazard effects. However, the relative importance of reduced work incentives is likely to be small. First, the reduction in the probability of returning to work appears to fall more or less proportionally with the total value of income support available, despite the fact that the relative importance of severance pay increases. If the rise in the duration of non-employment reflected purely a moral-hazard effect, it should increase substantially less than proportionally with the total value of income support. This also suggests that...
Box 2.3. Analysing the labour market effects of unemployment compensation systems in Brazil

In order to analyse the role of unemployment compensation systems for labour markets, this section makes use of a difference-in-differences approach that exploits the fact the eligibility to SP and UI depends on tenure in the previous job and is restricted to formal-sector job losers. While FGTS is in principle available to all formal-sector job losers who have been dismissed from their job, UI further depends on the number of months they have been employed in the formal sector during the past three years (see Box 2.1). In order to analyse the role of SP, the analysis distinguishes between workers eligible to the maximum number of months of UI with 24 to 48 months of tenure in their previous job and workers with more than 48 months. The difference in the value of SP between these two groups is considerable. Since the average level of tenure of job losers in the former is 29 months and in the latter 96 months, SP is over three times higher for job losers in the latter category. The difference-in-differences approach used here identifies the impact of unemployment compensation by comparing the average duration of non-employment or wage changes, \( E(y) \), of job losers in the formal sector \( f \) with those in the informal sector \( i \) in the same tenure group \( j \) relative to the difference in outcomes between job losers in the formal and informal sector with less than six months of tenure in the previous job (referred to with subscript 0).

\[
\alpha_{DID} = [E(y)_{f,j} - E(y)_{i,j}] - [E(y)_{0,f} - E(y)_{0,i}]
\]

The difference-in-differences approach controls for any unobserved differences in characteristics between formal and informal-sector job losers that are common across tenure groups and differences between jobs losers with more than six months of tenure in the previous job and those with less than six months of tenure that are common between formal and informal-sector workers. It also involves making two assumptions. First, it is assumed that the average value of FGTS among formal-sector job losers with less than six months of tenure in their previous job is negligible. This is reasonable given the short average level of tenure and the high incidence of temporary workers for whom monthly contributions are much smaller. However, it may lead to a slight underestimation of the impact of unemployment compensation systems on labour market outcomes. Second, it is implicitly assumed that characteristics that vary simultaneously across sector of job loss and tenure group do not affect the outcome of interest. In order to control for any such differences, the econometric analysis also controls for a wide range of observable characteristics.

The analysis makes use of data for the period 2002M3 to 2010M11 from the Monthly Employment Survey (Perquisa Mensal de Emprego, PME), a monthly survey for six major urban areas. The PME has a rotating panel that allows one to track individuals over time. The analysis focuses on the duration of non-employment spells of employees in the private sector who lose their job as a result of dismissal or firm closure. The PME provides rich information on the unemployed, including on the nature of their last job. This allows one to determine whether individuals are eligible for FGTS and the number of monthly payments of SD (e.g. 0, 3, 4 or 5) by using information on whether the person had a work card (carteira de trabalho) and the number of months spent in the last job. One drawback of the data is that they do not provide information on actual take-up of either SD or FGTS. However, take-up appears to be reasonably large. In 2009, on average every month about 760,000 individuals were dismissed from a formal job in the private sector without just cause, while on average every month about 600,000 entered into the SD system, suggesting that take-up among eligible unemployed persons may be close to 80%. A further shortcoming is that the employment history of unemployed individuals is limited to the last job only. As a result, one is likely to underestimate the maximum number of monthly
SD payments to which unemployed individuals are eligible or the amount that an individual has accumulated in his/her saving account. In principle, this problem should be most severe for unemployed workers who spent only a short period in their last job. Administrative data from the Ministry of Labour, however, indicate that less than 5% of benefit recipients were employed for less than six months in their last job, suggesting this is not a major issue.

1. A substantial part of these formal-sector job losers are employed on temporary contracts for which monthly contributions are only 2% of monthly earnings instead of 8% for permanent workers. Moreover, given their average level of tenure of slightly less than three months, they would only be eligible to at most a quarter of previous monthly earnings, if they had been employed on a permanent contract. Moreover, workers with less than three years of previous tenure are not eligible for the firing penalty (40% of total savings).

2. Hijzen (2011) shows that this corresponds to about ten and four months of previous earnings, respectively.

**Figure 2.6. Unemployment insurance and severance pay both tend to increase the duration of non-employment in Brazil**

Difference in the job-finding rate due to income support for workers with different tenure in the last job

<table>
<thead>
<tr>
<th>Duration of Non-Employment</th>
<th>0.05</th>
<th>0.00</th>
<th>-0.05</th>
<th>-0.10</th>
<th>-0.15</th>
</tr>
</thead>
<tbody>
<tr>
<td>6 to less than 12 months</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>24 to less than 48 months</td>
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<td></td>
</tr>
<tr>
<td>48 months and more</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Difference-in-differences estimates derived from the hazard ratio for each group (loosely defined as the number of individuals starting a job over the number of individuals staying out of work). The hazard ratios for each group are estimated using a complementary log-log model with group-specific baseline hazards that controls for random effects. The baseline hazard for each tenure group is approximated using piecewise constants for the following intervals: [1-2>, [2-3>, [3-4>, [4-5>, [5-6>, [6-8>, [8-9>, [10-12>, [13-27]. The model includes the following observable characteristics: five region dummies (omitted: Sao Paolo); four education dummies (omitted: more than ten years of education); age at dismissal as deviation from the sample average; age at dismissal squared as deviation from the sample average; a dummy for being female; two dummies for the first two terciles of the household income distribution; four race dummies (omitted: white); the log regional unemployment rate as a deviation from the sample mean. The sample is restricted to job losers due to dismissal or firm closures aged between 18 and 65.

Source: OECD's calculations based on PME (Perquisa Mensal de Emprego). http://dx.doi.org/10.1787/888932479629

the increase in the duration of non-employment due to UI largely reflects the role of liquidity constraints. Second, there is no evidence that job losers wait until their benefits have expired with searching for a new job. At the time of benefit exhaustion, the probability of returning to employment is not statistically different from the counterfactual outcome without UI. In sum, there is little evidence that UI reduces work
incentives overall, although it is possible that it reduces incentives for work in the formal sector that are offset by incentives to work informally.\textsuperscript{27}

A number of previous studies have analysed the role of UI and SP for the duration of unemployment in Brazil. Cunningham (2000) employs a difference-in-differences approach that exploits the relaxation in eligibility rules and the increase in the maximum duration of benefits that were introduced in 1994. Given the small increase in the generosity of benefits, it may not be surprising that she did not find much of an effect on the duration of unemployment.\textsuperscript{28} Domeland and Fiess (2006) find that receiving SP reduces the re-employment hazard of formal workers. As they do not control for the role of UI, the authors argue that the negative impact of severance pay reflects the impact of UI – which is conditional on SP eligibility – on moral hazard. While these results are, in principle, consistent with those presented above, the present analysis further suggests that SP receipt has an independent effect on the duration on employment. As SP is not conditional on being unemployed, this cannot be attributed to a moral-hazard effect, but is more likely to reflect a liquidity effect.

In order to investigate more fully the potential role of liquidity constraints, Figure 2.7 assesses the impact of unemployment compensation on the average re-employment probability of job losers across households with different levels of income.\textsuperscript{29} If liquidity constraints contribute to the non-employment-duration increasing impact of unemployment compensation, one would expect a larger impact among job losers in poor households.\textsuperscript{30} The figure suggests that this is indeed the case in practice. Unemployment compensation reduces the average probability of starting a new job by up to 5 percentage points in households with little or no alternative source of labour income (i.e. in the first two terciles of the household-income distribution) and has no statistically significant impact in households with alternative labour income worth over two full minimum wages (i.e. in the third tercile of the household income distribution). These differences are most pronounced among job losers eligible for the maximum level of unemployment compensation, i.e. five months of UI plus generous FGTS. These estimates, thus, provide further evidence that liquidity effects account for a substantial part of the positive impact of unemployment compensation on the duration of non-employment.

The role of income support for re-employment outcomes

The evidence so far suggests that unemployment compensation systems help job losers smooth their consumption during the period of unemployment and prevent liquidity-constrained job losers from being forced to accept the first job offer that arrives, even though waiting for a better job might have been desirable from a welfare perspective. Since unemployment compensation allows jobseekers to be more critical with respect to job offers, one might expect cash transfers to liquidity-constrained job losers also to contribute to better re-employment outcomes. In the context of emerging economies, having access to unemployment compensation may be particularly important in preventing formal-sector job losers from being pushed into informal work.

Despite the importance of liquidity constraints in emerging economies, there is little evidence on the effects of unemployment compensation systems on the re-employment outcomes of job losers. Cunningham (2000) finds for Brazil that UI has no impact on post-unemployment wages or the probability of finding a formal job, but increases the probability of becoming self-employed for men. Margolis (2008) analyses the role of FGTS and UI for transitions in the formal and informal sector. He finds that income support
2. THE LABOUR MARKET EFFECTS OF SOCIAL PROTECTION SYSTEMS IN EMERGING ECONOMIES

He concludes that unemployment compensation systems help some formal-sector job losers from being pushed into the informal sector. A potential drawback of his analysis is that he does not explicitly control for the independent role of having been employed in the formal sector or that of tenure in the previous job. As a result, it is not clear to what extent the higher (lower) probability of previously formal-sector workers to find a new job in the formal (informal) sector can be attributed to benefit eligibility.

Figure 2.8 presents new evidence of the impact of unemployment compensation on non-employment transitions into formal and informal employment for the case of Brazil. This not only allows one to get an idea of the extent to which unemployment compensation improves job matching, but also allows one to assess to what extent UI-eligible workers postpone job search until the time of benefit exhaustion or divert search efforts to the informal sector. The role of unemployment compensation is identified using the same difference-in-differences strategy as was used for the aggregate re-employment rate (see Box 2.3). The full results are reported in Hijzen (2011).

- In contrast to the aggregate analysis discussed above, the analysis of transitions into formal and informal employment suggests that moral hazard is potentially important. There are two reasons for this.
  - Income support reduces the job-finding rate in the formal sector by more than that in the informal sector, at least at the start of non-employment. This suggests that the moral-hazard effect of working informally during the period of benefit receipt tends to

Note: Difference-in-differences estimates derived from the hazard ratio for each group. The hazard ratios are estimated using a complementary log-log model with group-specific baseline hazards that controls for random effects. See notes to Figure 2.6 for further details.

Source: OECD’s calculations based on PME (Perquisa Mensal de Emprego).

http://dx.doi.org/10.1787/888932479648
offset the liquidity effect of income support that allows job losers to wait for a job offer in the formal sector. There is some evidence that this difference is smaller for job losers in households with liquidity constraints and larger for job losers who become self-employed (as opposed to informal salaried).

- There is some indication of a positive spike at five months for the re-employment rate in the formal sector. This suggests that some formal-sector job losers tend to wait before returning to formal work until their benefits expire. However, the spike is not statistically significant for any of the groups.

**Figure 2.8. Unemployment compensation reduces the job-starting rate in the formal sector in Brazil**

Difference in the job-starting rates by destination due to income support for workers with different tenure in the last job.

![Graph showing the job-starting rate in the formal sector in Brazil](image)

Note: Difference-in-differences estimates derived from the hazard ratio for each group. The hazard ratios are estimated using a complementary log-log model with group-specific baseline hazards that controls for random effects. See notes to Figure 2.6 for further details.

Source: OECD’s calculations based on PME (Perquisa Mensal de Emprego).

http://dx.doi.org/10.1787/888932479667

### 4. Building effective unemployment compensation systems in emerging economies

The case study for Brazil illustrates how SP and UI help cash-strapped households in their job search, leading to a potentially more efficient use of resources. However, both SP and UI may also be associated with potentially important costs, albeit of a very different nature. This section discusses the main policy challenges that governments in emerging economies have to confront when reforming or expanding their unemployment-compensation systems.

**A shift from a more job-oriented to a more worker-oriented approach to unemployment compensation may be appropriate in some countries**

A shift in emphasis from a largely job-oriented approach to unemployment compensation (SP) to a more worker-oriented approach (UI) may be appropriate. Increased competitive pressures associated with the integration of emerging economies into the world economy and technological progress requires more frequent adjustments of the workforce and greater firm
dynamics, while they may also have increased the demand for insurance against unemployment risks. SP not only slows the reallocation of resources between expanding and declining firms, but may also fail to provide adequate protection to job losers due to the tendency of firms to renege on their SP commitments at the time of dismissal. Linking reforms that aim to enhance labour market flexibility to those that seek to respond to the increased demand for UI may, therefore, be attractive from a political-economy perspective. A comprehensive reform may be more effective than piecemeal reforms because it allows one to compensate the losers of reduced job security with more effective income support when unemployed.

Broadly speaking, one may consider two possible strategies that simultaneously increase labour market flexibility and worker insurance against unemployment in emerging economies. The first strategy consists of reforming the severance-pay system by partially or fully transforming the firing penalty payable upon dismissal into a delayed payment. The delayed payment may take the form of a mandatory payment due at separation whatever the reason or a contingent withdrawal from an individual saving account that is portable across employers. The optimal balance of firing costs and delayed payments/mandatory savings is likely to differ across countries. The second strategy consists of fully or partially substituting severance pay by unemployment insurance. In this case, the reduction in severance pay is compensated by increased UBs which can be financed through general taxation or payroll taxes. It may also be possible to combine both strategies to maximise the relative advantages of ISAs for unemployment and UI.

**Individual saving accounts for unemployment accompanied by some form of redistribution could play a useful role**

Individual unemployment saving accounts (IUSAs) can provide a useful building block of unemployment compensation systems in emerging economies (Robalino et al., 2009). The main benefit of UISAs is their potential to provide support to liquidity-constrained unemployed in their job search, while limiting moral-hazard effects associated with OECD-style systems of unemployment insurance. By allowing workers to run down their personal saving accounts during periods of unemployment, workers internalise the cost of unemployment benefits, thus strengthening the incentives of the employed to prevent job loss and those of the unemployed to return to work quickly (Orszag and Snower, 1999). Consistent with this reasoning, Hartley et al. (2010) show, using administrative data for Chile, that IUSAs improve work incentives among the unemployed. As a result, the cost of providing UI in emerging economies does not have to be significantly higher in emerging economies with large informal sectors than in more advanced countries where working informally while receiving benefits is less obvious. Moreover, by relying on mandatory savings rather than payroll taxes for UBs, IUSAs may reduce labour costs and promote formal-sector labour demand (Robalino and Sanchez-Puerta, 2008). Their reliance on individual savings is also likely to reduce reservation wages and worker bargaining power, potentially reinforcing its positive impact on formal-sector labour demand.

The main drawback of IUSA systems relates to their potential to provide adequate protection to vulnerable workers. Pure IUSAs neither pool risks nor redistribute income and thus do not provide adequate coverage to the workers who need it most: those who experience frequent and/or long-lasting spells of unemployment are most likely not to have accumulated sufficient savings in their accounts (OECD, 2010a). The absence of redistribution implies higher contribution rates ceteris paribus than would be the case under a similarly generous UI system. This may provide incentives to move into informal work, particularly among low-income
workers. As a result, policy proposals have tended to concentrate on IUSA systems that include some form of redistribution, either by allowing unemployed workers to borrow or by combining individual accounts with a traditional UI component.

- By allowing individuals to have negative account balances, the IUSA-plus-borrowing alternative reduces the problem of adequate coverage and reintroduces some redistribution by forgiving any negative account balances at the time of retirement. However, the extent of coverage remains limited compared with traditional UI. The option of borrowing also potentially re-introduces adverse work incentives among unemployed individuals with negative account balances. In order to ensure that individuals with negative balances do not withdraw from the labour market or move into informal work, pension contributions could be used as collateral (Stiglitz and Yun, 2005). This option has not been implemented anywhere yet.

- Combining IUSAs with unemployment insurance provides an alternative approach to ensure adequate coverage by providing individuals with insufficient account balances with UBs from an unemployment insurance fund. This approach is likely to involve more redistribution than the UA-plus-borrowing alternative but less than in a pure system of UI. However, the provision of UBs to individuals with insufficient savings also reintroduces the issue of moral hazard. Indeed, Hartley et al. (2010) show for Chile, which implemented an individual accounts system with UI in 2001 (see OECD, 2009, for details), that unemployed individuals who rely on collective insurance take longer to get re-employed than other unemployed job-seekers.

Determining whether or not a system of individual unemployment accounts could be appropriate is not straightforward due to the trade-off between improved work incentives under IUSAs and risk pooling under UI. A number of factors are likely to play a role. First, it seems plausible that this trade-off becomes more favourable in emerging economies with large informal sectors since informality increases the scope for moral hazard and reduces the benefits of risk pooling. Second, IUSAs are likely to be more appropriate when the objective is to smooth consumption rather than unemployment-related poverty alleviation. By contrast, unemployment compensation systems that put more weight on alleviating unemployment-related poverty require more redistribution which may be more effectively provided by traditional UI. Third, individual IUSA systems are more effective in the context of frequent and short unemployment spells. These are more important in flexible labour markets that are characterised by relatively high levels of job creation and destruction.

**Investments in UBs need to be accompanied with investments in benefit administration and re-employment services**

A number of the emerging economies considered in this chapter may be interested in strengthening their unemployment compensation systems by establishing a system of unemployment insurance in the form of a standalone UI plan or a IUSA system with a solidarity fund or expand an existing programme. The design and scope of UI should seek to minimise potential moral-hazard effects and maximise its support to liquidity-constrained job losers. Given the difficulty of determining and monitoring continued benefit eligibility in the context of large informal sectors and a weak administrative capacity, it will be important to ensure that benefit schedules preserve good incentives for work in the formal sector. This suggests that, at least initially, benefits with relatively low replacement rates and short durations may be most appropriate. With time, as the ability to administer benefits effectively improves, the generosity of UB could be increased in line with labour market needs. Declining
benefit schedules as in Chile and the Russian Federation also contribute to maintaining good work incentives over the unemployment spell. In order to maximise the welfare effects of unemployment insurance, benefits need to be targeted towards job losers who are most likely to make sub-optimal employment choices as a result of liquidity constraints. An obvious place to start would be to offer flat benefit schedules, as in China, or means-tested replacement rates, as in Brazil, where benefits are bound between one and two minimum wages depending on one's previous income.

Efforts to strengthen unemployment compensation should be accompanied by investments in activation policies in order to avoid the risk of benefit dependency and help job seekers overcome important adjustment costs or avoid skill mismatch. The essence of activation is the principle of “mutual obligation” under which, in return for paying benefits and offering re-employment services, the government requires recipients to search actively for a new job or participate actively in training and employment programmes to improve their employability. The government can enforce this requirement with the threat of moderate sanctions. Over the past decade, many OECD countries have introduced or reinforced strategies to “activate” the unemployed. Evidence suggests that, if well-designed, such strategies can contribute to better labour market outcomes, by ensuring that benefit recipients have a better chance of getting a job and minimising the risks that generous benefits reduce work incentives (OECD, 2006; OECD, 2010b). UI plans in emerging economies share some of the features of the activation approach. Except for Brazil, job losers are required to register with the public employment service (PES) in order to be able to apply for unemployment benefits. Moreover, continued benefit eligibility tends to be conditional on being available for work, actively engaging in job search and not refusing acceptable job offers. However, in practice, monitoring of continued benefit eligibility tends to be very limited and it may be quite common for benefit recipients to work in the informal sector.

The optimal strictness with which benefit eligibility criteria are enforced and the intensity of job-search assistance depend, amongst other things, on the specific design features of the UI plan (OECD, 2010b). In countries with a relatively short maximum duration of benefits, such as Brazil and Chile, activation may be relatively light. As the benefits are only available for a short duration, work incentives are likely to remain strong during the period of benefit receipt, while the gains from intensive activation measures are relatively small. Moreover, as benefit recipients have recent work experience, there may be little need for intensive counselling or active labour market programmes. The main role of the PES in this case may be to administer initial benefit eligibility and to act as a job broker by providing vacancy information. Available data for Brazil and Chile suggest that the number of job seekers who get a job through the PES is rather low. The ratio of the number of placements to the number of newly registered job seekers is about one in six, while the ratio of placements to the number of new job vacancies is about one half (Gonzalez, 2010, for Brazil; OECD, 2009, for Chile). In countries, where benefits are available for a relatively long duration, such as China and the Russian Federation, activation measures may have a potentially important impact on unemployment. At least in the context of OECD countries, it has been suggested that even low benefits could bring about high rates of benefit dependency in the absence of effective activation measures (OECD, 2010b). This suggests that the PES may have to monitor and enforce continued eligibility more intensively and engage in the development of individual action plans (see, for example, Vodopivec and Tong, 2008, for China). In general, this is likely to require a greater coordination of benefit administration and re-employment services.
PART B.
The Impact of Cash Transfer Programmes on Labour Market Outcomes

5. Cash transfer programmes in emerging economies

As discussed in Section 1 and Part A, social insurance has a limited reach in emerging economies, and social assistance programmes have been developed to provide basic coverage to a substantial share of the population. In this context, cash transfer (CT) programmes have become an important element of the social protection systems of most emerging economies. CTs aim at reducing poverty, managing risk, smoothing consumption throughout the year, minimising the impact of adverse shocks on households’ lives and promoting human capital development. CTs can target poor households in general, those with small children (mainly conditional cash transfers) and other specific groups such as the sick and disabled, the elderly and ethnic minorities.

A broad range of cash transfers exist in emerging economies

CT programmes exist in all the emerging economies covered in this chapter. Table 2.2 presents a taxonomy based on Barrientos et al. (2010) of the different programmes in operation in the emerging economies:

- A first group of programmes provides pure income transfers (Table 2.2, Panel A). The majority of such CT programmes in the emerging economies target the elderly (known as non-contributory pensions – NCP, or social pensions – SP) and exist in most of the countries covered in this chapter. The Chinese Dibao is an unconditional cash transfer programme, in the same category as is the extensive Child Support Grant in South Africa which, although it provides cash to care givers of children, does not impose any conditionality on schooling or health tests.

- A second category are programmes that condition recipiency on actions on behalf of beneficiaries in terms of investment in education and medical check-ups for children and pregnant women (the CCTs) (Table 2.2, Panel B). Bolsa Familia, Oportunidades, Subsidio Unico Familiar in Chile, the Indonesian Keluarga Harapan and the Conditional Educational and Health Support Programme in Turkey are the main CCTs operating in the emerging economies in terms of coverage. Among these programmes, the programme Apoyo para Adultos Mayores in Mexico is the only CT which targets adults aged above 70 in households participating in Oportunidades and imposes certain conditionalities related to medical visits.

- A third category of programmes includes those that provide short-term assistance combined with a long-term anti-poverty strategy (Table 2.2, Panel C). Chile Solidario is a typical example of such an integrated poverty programme. The benefits paid to families are only a small and relatively limited part of the programme’s contribution which lies in the provision of personal counselling and psycho-social assistance to vulnerable households and access to social services in the areas of healthcare, education, employment, housing and justice (Barrientos et al., 2010). In addition, Chile Solidario aims at improving access to economic and social networks by providing a bridge among the different social assistance programmes. Oportunidades and Bolsa Familia are also moving towards integrating other existing anti-poverty programmes under their umbrella but these programmes are different in nature from Chile Solidario and the benefits paid are relatively generous and constitute a main element of the programmes.
### Table 2.2. **Main cash transfer programmes in the emerging economies**

<table>
<thead>
<tr>
<th>Name (date of creation)</th>
<th>Targeted population</th>
<th>Means- test</th>
<th>Share of population covered</th>
<th>Share of targeted group covered</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Panel A. Unconditional cash transfers</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil Previdência Rural (1971)</td>
<td>Rural labourers (informal workers in agriculture, mining, and fishing) 55+ for women and 60+ for men</td>
<td>No</td>
<td>8.8% of Brazilian workers</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Beneficio de Prestação Continuada (1996)</td>
<td>65+ in households with household income below USD 60 a month and no other gov. programme</td>
<td>Yes</td>
<td>1.6 million</td>
</tr>
<tr>
<td>Chile Pensión Básica Solidaria de Vejez (PBS) (2008)</td>
<td>65+ with no other pension and below certain score in Ficha de Protección Social</td>
<td>Yes</td>
<td>Target of 55% of relevant population</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Aporte Previsional Solidario (APS) (2008)</td>
<td>65+ with pensions below 200 000 Chilean Pesos (2010)</td>
<td>Yes</td>
<td>Target of 60% of relevant population</td>
</tr>
<tr>
<td>China Dibao (1999)</td>
<td>Poor households with no ability to work, no source of income, and no support from family members</td>
<td>Yes</td>
<td>5.3% of total population</td>
<td></td>
</tr>
<tr>
<td>India Indira Gandhi National Old-Age Pension Scheme (2007)</td>
<td>65+ who are below the poverty line, 60+ if they have some serious illness</td>
<td>Yes</td>
<td>28% of 65+ population</td>
<td></td>
</tr>
<tr>
<td>Mexico 70 y más (2007)</td>
<td>70+ in areas with less than 30 000 inhabitants</td>
<td>No</td>
<td>33% of 70+ population, 96% of 70+ population in targeted areas</td>
<td></td>
</tr>
<tr>
<td>Russia Social Pension for the Elderly</td>
<td>65+ for men and 60+ for women without a labour pension</td>
<td>No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>South Africa Child Support Grant (1998)</td>
<td>Children aged 17 (2010) or below in poor households</td>
<td>Yes</td>
<td>36.6% of households</td>
<td>54% of children below 15</td>
</tr>
<tr>
<td>Old-Age Pension (1928)</td>
<td>65+ men and 60+ women in poor households</td>
<td>Yes</td>
<td>15.3% of households</td>
<td>80% of 60+ population</td>
</tr>
<tr>
<td>Turkey Elderly Support Programme (1999)</td>
<td>65+ with no other social security rights</td>
<td>Yes</td>
<td>16.7% of 65+ population</td>
<td></td>
</tr>
<tr>
<td><strong>Panel B. Conditional cash transfers</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil Bolsa Familia (2003)</td>
<td>Extremely poor families and poor families with children</td>
<td>Yes</td>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>Chile Subsidio Unico Familiar</td>
<td>Poor families</td>
<td>Yes</td>
<td>17% of total population</td>
<td></td>
</tr>
<tr>
<td>Indonesia Program Keluarga Harapan (2007)</td>
<td>Poorest households</td>
<td>Yes</td>
<td>720 000 households</td>
<td></td>
</tr>
<tr>
<td>Mexico Oportunidades (1997)</td>
<td>Poor families with children</td>
<td>Yes</td>
<td>19% of households; 20.6% of &lt;18 population</td>
<td>43.5% of &lt;18 in poor households</td>
</tr>
<tr>
<td></td>
<td>Apoyo para Adultos Mayores dentro de Oportunidades (2006)</td>
<td>70+ not covered by 70 y más and who are integrated in households participating in Oportunidades</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Turkey Conditional Educational and Health Support Programme (2003)</td>
<td>Poor families with children aged 0-6 or in primary or secondary school, and pregnant mothers</td>
<td>Yes</td>
<td>5.9% of households</td>
<td></td>
</tr>
<tr>
<td><strong>Panel C. Integrated programmes</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile Chile Solidario (2002)</td>
<td>Extremely poor and poor families (conditionalities attached)</td>
<td>Yes</td>
<td>6% of total population</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** The information in this table is not exhaustive and only covers the main programmes operating in the emerging economies. In most of the countries covered, other smaller programmes with national or very often local coverage exist. Many of these countries also operate old-age pension plans for the disabled, widowed and other categories of the elderly, but these are not covered in this chapter. Source: OECD Secretariat based on various sources; see Annex 2.A4 in OECD (2011b).

**Cash transfers are independent of labour market status and target mainly the poor**

Unlike similar programmes in advanced economies, CT programmes in the emerging economies are not conditional on labour market status, which makes sense given the high incidence of in-work poverty in these countries. They are mainly provided to the population in need, usually defined on the basis of geographic location, income and other household or family characteristics, such as the presence of young children and older
household members. Targeting is often done first through selection of location (rural versus urban, poorest regions versus less poor ones) and second through a means-test in order to identify the neediest individuals and households. In all the programmes covered in Table 2.2, except Previdencia Rural in Brazil, the Social Pension for the Elderly in Russia, and the programme 70 y más in Mexico, a means-test is used to ensure that only poor individuals become beneficiaries. These means-tests are usually performed once to determine eligibility and are only repeated in rare cases. In most programmes, proxy means-tests are used, based on a formula to estimate household income that considers a number of household characteristics and composition. Only Bolsa Familia and the OAP in South Africa, base the means-tests on an actual income declaration.

**Social pensions tend to be more generous than general cash transfers targeting poor households**

The generosity of the CT programmes varies a great deal across countries, but overall, programmes targeting the elderly seem to be relatively more generous than those targeting poor households in general (Figure 2.9). The Brazilian Previdencia Rural and Beneficio de Prestação Continuada are the most generous programmes paying an average benefit equivalent to 35% of average wages (equal to the minimum wage in the country). Among the CT programmes targeting poor households, the most generous is Oportunidades, which offers 17% of the average wage to about 5.8 million families. As a result of varying coverage and generosity levels, the total public spending on these programmes also varies greatly among countries. The most costly programmes are the South African OAP (1.4% of GDP

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**Figure 2.9. CTs targeting the elderly are more generous than those targeting poor households**

<table>
<thead>
<tr>
<th>Programme</th>
<th>Expenditure (% of GDP)</th>
<th>Average transfer (% of average wage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Previdencia Rural</td>
<td>1.5</td>
<td>35%</td>
</tr>
<tr>
<td>Bolsa Familia</td>
<td>0.8</td>
<td>20%</td>
</tr>
<tr>
<td>Previdencia Social</td>
<td>1.2</td>
<td>25%</td>
</tr>
<tr>
<td>Solidaridad</td>
<td>0.5</td>
<td>10%</td>
</tr>
<tr>
<td>Beneficio de Prestación</td>
<td>0.3</td>
<td>5%</td>
</tr>
<tr>
<td>Continuada</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Bolsa Solidaria</td>
<td>0.2</td>
<td></td>
</tr>
<tr>
<td>Solidário</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Beneficio de Prestación</td>
<td>0.6</td>
<td></td>
</tr>
<tr>
<td>Solidario</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>Oportunidades</td>
<td>0.2</td>
<td></td>
</tr>
<tr>
<td>70 y más</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Old Age Pension</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Child Support Grant</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Old Age Support Grant</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Old Age Support Grant</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Conditional Educational</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>and Health Support Programme</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Child Support Grant</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Conditional Educational</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>and Health Support Programme</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Child Support Grant</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Conditional Educational</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>and Health Support Programme</td>
<td>0.1</td>
<td></td>
</tr>
<tr>
<td>Child Support Grant</td>
<td>0.1</td>
<td></td>
</tr>
</tbody>
</table>

Note: Data on total expenditure are missing for Subsidio Unico Familiar in Chile; data on average transfers are missing for the Indira Gandhi Old-age Pension in India and the Conditional Educational and Health Support Programme in Turkey. 
Source: OECD Secretariat based on various sources and years; see Annex 2.A4 in OECD (2011b).

http://dx.doi.org/10.1787/888932479686
in 2008) and the Brazilian Previdencia Rural (1.3% of GDP in 2009). Among the CTs not targeting specifically the elderly, big programmes such as Oportunidades and Bolsa Familia have annual expenditures representing between 0.4 and 0.5% of GDP.

6. The impact of cash transfers on labour market outcomes: A case study for South Africa

There is a growing empirical literature evaluating the labour market effects of various CTs programmes around the world. The differences in the estimated effects across countries, programmes and studies can be attributed to differences in the programmes' objectives, their setup and coverage, the structure of the labour market, and very importantly, differences in the data and the specific methodology used for the evaluation of the labour market effects.

This section analyses the labour market effects of CTs in the case of South Africa, a country characterised by a well-developed system of social grants covering many population groups and a total of 14 million beneficiaries (representing about 29% of the total population) in 2010 (Box 2.4). South African social grants are fairly generous (with the

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**Box 2.4. Social assistance in South Africa**

South Africa’s social assistance programmes have their roots in the first half of the XXth century and were introduced with the objective to support white people. The state welfare system was substantially reformed after the end of Apartheid. Until then, the system was mainly dominated by means-tested, non-contributory old-age and disability pensions with conditions attached to the size of the benefit as well as eligibility that favoured the white population. The reform aimed at changing this and, twenty years later, the picture has been reversed, with the majority of grant beneficiaries being black Africans.

**The expansion of the social assistance system**

<table>
<thead>
<tr>
<th>A. Social assistance coverage and cost</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Beneficiaries (thousands)</strong></td>
</tr>
<tr>
<td><strong>Expenditure (thousands ZAR)</strong></td>
</tr>
</tbody>
</table>

- Old Age Pension
- Disability Grant
- Child Support Grant
- Foster Child
- Other

<table>
<thead>
<tr>
<th>B. Households reporting any income from grants, percentage of total households</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Non-black</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>% Non-black</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
<tr>
<td>% Black</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
</tbody>
</table>

At the same time, there has been a sharp increase in expenditure on welfare and social assistance (Niño-Zarazúa et al., 2010) from ZAR 30.1 billion (3.2% of GDP) in 2000/01 to ZAR 101.4 billion (4.4% of GDP) in 2008/09. The coverage of social grants in South Africa has increased by 50% between 2005 and 2010. The bulk of the increase is driven by the expansion of CSG by 72% between 2005 and 2010, reaching a total of 9.6 million children (and over 10 million in 2010/11). As shown in Panel B of the figure, the share of households receiving some income from social grants has increased substantially in the past eight years and even more so for black African households. Grant recipiency has risen sharply among the black population, from just below 30% in 2002 to above 50% in 2008, whereas this share has remained fairly stable for the non-black population. The impact of the social grants on limiting the extent of poverty has been substantial. According to Woolard and Leibbrandt (2010), without government grants poverty would have worsened between the end of apartheid and today, mainly because unemployment has increased and hence labour income has become less important for a large number of households.

The labour market effects of the largest two CT programmes in South Africa are examined in this section: the OAP and CSG. The OAP was introduced in 1928, but has been heavily reformed since then. It is an extensive and relatively generous system, covering more than 80% of the elderly population (Leibbrandt et al., 2010) and offering about twice the median per capita income to pensioners (married couples may receive up to twice the amount single pensioners receive). The age eligibility is 60 for women and has gradually dropped from 65 to 60 for men. In principle, the amount of the pension is means-tested and there is a reduction by 50 cents for every Rand of other income earned. In practice, however, everybody gets the full amount. The means-test makes ineligible almost all the white population and about 20% of the black population. The OAP is considered as a fairly successful programme in reaching the poor in rural areas, women but also children in three-generation households and contributes in significant ways to poverty reduction for households (Ardington and Lund, 1995). Women are over-represented among beneficiaries (more than two-thirds of beneficiaries) because they are eligible at a younger age and live longer. In addition, they are less likely to be eligible for contributory (private) pensions because of their poorer labour market performance and weak labour force attachment (Leibbrandt et al., 2010).

The CSG was created in 1998, and was initially based on a household income means-test and imposed various constraints in terms of documents collection but also requirements to show efforts to secure income from other sources. As a result, take-up was fairly low and led to the revision of the eligibility conditions and other related requirements. The CSG changed the approach of child-related social transfers in South Africa by paying the benefit to the care-giver rather than to the child. As a result, women who were the majority of care givers were given some freedom in the use and allocation of such funds. Initially, the means-test was applied to the household income, but because of low take-up rates in the early years of operation of the programme, this was altered to only include the income of the care giver and his/her spouse. In 2008, the means-test was amended and was set at ten times the value of the grant. In addition, the means-test is doubled for married couples with two earners, making it more generous and hence more likely to pass it for poor households. In addition, substantial increases have taken place in terms of the benefit level, which increased from ZAR 100 in 1998 to ZAR 250 in 2010/11, reaching 2% of average wages.
exception of the CSG), and eligibility is based on a number of group-specific conditions but also a relatively weak means-test. A comparison between the potential labour market effects of the OAP and the CSG, two programmes with different target populations, eligibility rules and more importantly different levels of benefits paid, allows a better understanding of the mechanism through which CTs may affect labour market outcomes.

CTs can affect labour-market-related decisions and outcomes of beneficiaries, their families and other household members through several channels. In the case of most emerging economies, where extended families are the norm, spillover effects of CT receipt on other household members can be particularly important if income is pooled in the household. CTs may also have broader effects on the community or local markets with subsequent feedback effects on beneficiary households. CTs can have a direct impact on labour force participation and employment rates, as well as longer-term effects through investments in schooling and health for children. However, the analysis presented here is mainly concerned with the short-term effects of CTs.

**The income and substitution effects of cash transfers on the labour markets are likely to be negative and relatively small**

Income transfers affect labour supply decisions through an income and a substitution effect. The income effect suggests that if leisure is a normal good, labour supply will drop when household income increases. In the emerging economies, where benefit levels are fairly low in comparison with those in the OECD countries, the expected impact on labour supply is likely to be small.\(^{44}\) In addition, CT programme beneficiaries in emerging economies are generally very poor and the income elasticity of leisure is likely to be low. Moreover, for some households, the reduction in income from child work and the increase in school expenditures associated with the additional school enrolment in the case of conditional cash transfers can offset the amount of the transfer, implying a limited pure income effect of the transfer (Grosh et al., 2008).
The substitution effect operates in the same direction by reducing labour supply incentives if CTs are conditional on labour market status or if there is a means-test that imposes an effective marginal tax rate on labour supply, as is the case for the majority of programmes reviewed in this chapter (see Table 2.2). Potentially eligible beneficiaries understand that they may have to reduce labour supply in order to pass the means-test providing access to the CT. The substitution effect depends on whether the means-test of the programme is binding or not, that is, whether it imposes an implicit tax on labour income. In the South African OAP, this is very unlikely given that the income bracket that determines eligibility is fairly high and hence is not binding for the majority of black candidates who represent the main group of beneficiaries. In addition, means-tests are not performed regularly. This is in contrast to such programmes in the OECD countries, where eligibility is conditional on labour market status and regular checks are the norm. In programmes such as Oportunidades, the fact that the means-test is evaluated only every three years, combined with relatively weak administrative capacity of the authorities, may imply limited actual enforcement of any benefit withdrawal decision. Likewise, in the majority of programmes covered in this chapter there is no provision for gradual withdrawal of the benefit in case of increases in the beneficiary’s income. One exception to this is the OAP in South Africa. Moreover, the use of proxy means-tests relative to actual income declarations in the emerging economies implies a less direct link with earned incomes in these countries compared with the OECD countries.

To the extent that means-tests and deductions of non-contributory benefits relative to income from informal work raise the effective marginal tax rate on income from a formal job, they can increase the likelihood of informal employment, or the time that people spend on informal work. The final outcome depends on the extent of the wage gap between the formal and the informal sectors on the one hand, and on the generosity and eligibility conditions of the non-contributory programme on the other. A high effective marginal tax rate is likely to have a smaller effect in the case of large productivity differences between formal and informal employment. This possible labour market effect is similar to the one expected in the case of non-contributory health programmes (see Part C below) but is unlikely to be relevant in the case of most CTs which are not related to the labour market status of the beneficiary.

Alleviating liquidity constraints through cash transfers may help overcome barriers to labour force participation and improve productivity

When CT programmes are targeted at older household members and children, such income can relax care constraints (imposed by the presence of older and/or younger household members) and this effect is likely to be more important in emerging economies in comparison with OECD countries because of the extended family and household structures characterising the former. As a result, other adult members are enabled to look for work outside their homes and in some case migrate to work in neighbouring communities or the city. On the other hand, CCTs may impose time constraints to parents (especially for mothers) who are asked to accompany their children to health clinics and who are hence obliged to reduce their work hours (Grosh et al., 2008).

CTs can increase the time spent on job search, thereby improving labour market outcomes and future incomes. By allowing riskier investments, CTs can also increase productivity. Moreover, by providing basic income support, social transfers enable
individuals to avoid less efficient insurance mechanisms and beneficiary households may be able to finance additional schooling for the children and young adults, leading to higher future earnings.

**The empirical evidence on the impact of cash transfers on labour market outcomes is mixed**

Despite the availability of appropriate micro-data in many countries in Latin America as well as South Africa, the empirical evidence on potential labour market effects in the emerging economies covered in this chapter remains fairly limited and focuses mainly on a few countries, such as Mexico, Brazil, Chile and South Africa. The empirical evidence on the impact of social grants on labour supply in South Africa is more extensive compared with that on Latin America. This is mainly explained by the generosity and extensive coverage of these programmes on the one hand and the availability of good-quality micro-data allowing advanced empirical analyses, on the other. It may also reflect the specific labour market situation in South Africa which leaves an important part of the population in unemployment and eventually in inactivity. Overall, a broad range of programmes are examined in the literature and a variety of methods and data are used, showing varying results (a review of these studies can be found in Annex 2.A3 in OECD, 2011b).

**The labour market impact of cash transfers targeting the elderly is not clear-cut**

Early evidence from South Africa suggested fairly negative effects of the OAP on labour force participation of younger adult household members. Bertrand et al. (2003) show a drop in the labour force participation of prime-age resident males in households with pension beneficiaries while participation of resident women remains unaffected. By contrast, using LFS data between 2001 and 2004, Ranchhod (2010) finds that the cessation of OAP significantly increases employment rates for middle-aged and older men and women with a pensioner leaving the household.

Moreover, in the context of the South African extended families and the high internal migration rates, restricting the impact to resident members of the household may not necessarily give the full impact of CTs since it might miss out the behaviour of the non-resident migrant workers (Posel et al., 2006). In addition, household composition may be endogenous to the receipt of a social grant as argued by Ardington et al. (2009). The authors use panel data for the KwaZulu-Natal region and find that the negative impact on labour supply disappears when the impact on non-resident household members is taken into account. Instead, a small positive impact on participation is found especially for non-resident members, indicating a rise in the likelihood of becoming labour migrants.

With the objective to provide more insights on the potential impact of social transfers on broader labour market outcomes, new econometric evidence from South Africa is presented in this section. The analysis is novel because of the data used, the long period examined and in particular the population group that is analysed. The impact of the OAP on labour market outcomes of young and prime-age adults is identified by comparing black adults (20-45 years old) in households with eldest members just above the age-eligibility threshold for receiving the OAP with those in households with eldest members just below the age threshold and hence not likely to be receiving the OAP. Although this comparison
does not allow one to draw general conclusions because it is based on a specific sample, it is likely to be more appropriate than comparisons between households that receive the OAP and those that do not because there is a reduced risk of interpreting the effect of unobserved factors that jointly determine household composition and labour market effects as a pure OAP effect on individual labour market outcomes.

The new evidence on the potential impact of the OAP on adult household members is presented in Figure 2.10. While the main focus of the analysis is on labour supply, results for employment and unemployment are also reported. In the context of South Africa, it is important to consider two definitions of labour force participation and unemployment, the broad and the standard one. Broad unemployment includes discouraged workers who are ready to start working but not actively search for a job whereas standard unemployment only includes those who are also actively searching for work. Likewise, broad labour force participation includes discouraged workers who are willing to work but do not actively engage in job search. Standard labour force participation does not include discouraged workers. The results indicate that women aged 25-40 living in households with OAP-eligible adults are less likely to be employed and more likely to be unemployed compared with those in households with no OAP-eligible members. For men, the sole negative and significant effect is found on the probability of standard labour force participation.

Figure 2.10. **The impact of OAP on basic labour market outcomes**

![Graph showing the impact of OAP on basic labour market outcomes](http://dx.doi.org/10.1787/888932479705)

OAP: Old Age Pension.

* *, **, ***: statistically significant at the 10%, 5% and 1% level, respectively.

a) Samples include black women and men aged 20-45.
b) The coefficients presented are marginal effects estimated from separate regressions which include controls for age, education, marital status, household size, location (province dummies), the number of children by age group (0-5, 6-8, 9-10, 11-13 and 14), the number of adults aged above 55, total household expenditure, a dummy variable on the type of dwelling (informal versus other) and controls for a number of dwelling characteristics such as the quality of the roof and the walls and access to electricity.
c) Broad labour force participation includes discouraged workers who are willing to work but do not actively engage in job search. Labour force participation refers to standard participation and only includes those who actively search for work. Likewise, broad unemployment includes those who are ready to start working and (standard) unemployment those who have actively searched for work. All others are classified as non-participants.

Poor households are more likely to face liquidity constraints and hence are expected to react in different ways to the receipt of the grant compared with less poor households.49 Overall, no major differences are found when the effect of OAP eligibility is estimated for households by their dwelling's status. Only men in poor households with an eligible eldest member are less likely to be unemployed compared with men in households without eligible members or those in non-poor households with eligible members (see Puymoyen and Xenogiani, 2011).50

As noted above, social pensions are also likely to affect the composition of employment between the formal and the informal sectors by lowering the incentives to participate in the contributory programme. Evidence from the Chilean pension system prior to the 2008 pension reform shows increased incentives for informal work and reduced pension contributions for future eligible beneficiaries (Valdés-Prieto, 2009). This effect was mainly driven by the design of Pensión Asistencial (PASIS) and the minimum pension guarantee (MPG). For the former, low-income workers had the incentive to contribute up to the point where the contributory pension would be at least half of the minimum pension because, after that point, the amount paid by PASIS would be zero (a 100% EMTR). The same held for MPG, which required only 20 years of contributions. Beyond that point, there were increased incentives to work informally and evade contributions. The current pension system has indeed improved incentives related to participation and contributions in the contributory programmes, by achieving far greater integration of the two systems. This is done through a gradual withdrawal of the social pension under the reformed system, in comparison with the pre-2008 programmes.

Less generous programmes may be more neutral to the labour market...

Since general CT programmes that do not target the elderly in emerging economies are less generous compared with social pensions (Figure 2.9), they are likely to have a smaller impact on the labour market. Indeed, existing evidence from Brazil, Mexico and South Africa seems to suggest that CTs targeting poor households have small or even positive effects on individual labour market outcomes. Oportunidades in Mexico is not found to have any negative impact on labour supply (Skoufias and Di Maro, 2008). Similar results in terms of labour supply are found for the CCT programmes in Brazil (Medeiros et al., 2008), except for women heads of households for whom a negative effect on labour supply is found.51 In a recent study of CCTs in Brazil, Foguel and Paes de Barros (2010) find a small positive impact of the programme on male labour force participation, and a small negative impact on hours worked for women earning above the median household income. In a comparative paper, Alzúa et al. (2010) use a difference-in-differences approach to analyse the impact of selected CCTs in Mexico, Nicaragua and Honduras. They find no evidence of negative and significant effects on employment or of any labour reallocation between agriculture and other sectors. Finally, in a recent paper by Ribas and Soares (2011) a differential impact of the programme is found in poor areas and large cities in Brazil. In the former, Bolsa Família is associated with an increase in labour supply even if this is translated into higher unemployment rather than employment, possibly because of the lack of available jobs and a reduction in hours worked, whereas in the latter it is associated with a decline in labour supply and participation in the formal sector.

Empirical evidence on South African Child Support Grant is scarcer compared with that on OAP, mainly because of the difficulty in identifying an adequate evaluation strategy and also possibly because of the substantially lower benefit paid by the programme. Eyal and
Woolard (2010) provide the most recent and complete study of the CSG and its impact on labour markets using a variety of techniques. Grant receipt is associated with a higher probability of labour market participation, lower unemployment rates and a higher probability of being employed.

The impact of the CSG on labour market outcomes is examined with a variety of methods in Tables 2.3 and 2.4 (for more details, see Box 2.5 and Puymoyen and Xenogiani, 2011). The main impact of the CSG on individual labour market outcomes can be summarised as follows:

- Mothers with age-eligible children to receive the CSG, have a higher probability of broad labour force participation (Table 2.3, row 1). However, increased participation seems to result in a higher probability of unemployment (both broadly and narrowly defined) rather than higher employment rates. The higher effect on narrow unemployment compared with that on broad unemployment, may suggest that mothers of eligible children are relatively more likely to engage in active job search.

- Most labour market effects seem to disappear when comparisons are drawn between mothers of eligible and non-eligible children one or two years above and below the cut-off point. Having a CSG age-eligible child only increases the probability of (broad) labour force participation for mothers and relative to those with children one or two years above the age eligibility cut-off (Table 2.3, rows 2-3). This is in line with the evidence in Eyal and Woolard (2010) and suggests that when comparisons are drawn between two appropriately-defined groups who are less likely to differ in other substantial ways, the impact of potential CSG receipt is close to zero for most labour market outcomes and only mildly positive for broad labour force participation of mothers.

Table 2.3. CSG receipt affects labour market outcomes

<table>
<thead>
<tr>
<th>Age eligibility</th>
<th>Labour force participation</th>
<th>Broad participation</th>
<th>Employment</th>
<th>Unemployment</th>
<th>Broad unemployment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age eligibility</td>
<td>0.012</td>
<td>0.033**</td>
<td>-0.012</td>
<td>0.044**</td>
<td>0.039**</td>
</tr>
<tr>
<td>Youngest child 1 year from cut-off</td>
<td>0.032</td>
<td>0.051*</td>
<td>-0.007</td>
<td>0.051</td>
<td>0.041</td>
</tr>
<tr>
<td>Youngest child 2 year from cut-off</td>
<td>0.000</td>
<td>0.037*</td>
<td>0.003</td>
<td>0.005</td>
<td>0.023</td>
</tr>
</tbody>
</table>

*, **, ***: statistically significant at the 10%, 5% and 1% level, respectively.

a) Samples include black African mothers aged 20-45.

b) The coefficients presented are marginal effects estimated from separate regressions. See note c in Figure 2.10 for a list of the variables included in the regressions and the definition of (broad) labour force participation and (broad) unemployment.

c) Observations are clustered at the household level.


...and may be less negative and even positive for poor households

Table 2.4 presents the analytical results for mothers by allowing for a differential impact between poor and non-poor households. When all mothers are considered (Panel A), actual CSG receipt increases the likelihood of broad participation more for mothers in poor households relative to those in non-poor households. In addition, the impact of CSG receipt on standard participation is negative for mothers in non-poor households and may be positive for those in poor households. Moreover, both the negative impact on employment and the positive one on unemployment become less important.
2. THE LABOUR MARKET EFFECTS OF SOCIAL PROTECTION SYSTEMS IN EMERGING ECONOMIES

OECD EMPLOYMENT OUTLOOK 2011 © OECD 2011

Panel B of Table 2.4, presents comparisons between mothers with children two years below/above the age-eligibility cut-off. The results suggest that CSG receipt is associated with improved labour market outcomes for mothers in poor households, in comparison with those in non-poor households. Mothers receiving the CSG on behalf of their children are more likely to be in the labour market if they are in poor households. In addition, they are more likely to be employed both relative to CSG beneficiaries in non-poor households and non-CSG beneficiaries. Moreover, their chances of being unemployed are lower compared with those of CSG beneficiary mothers in non-poor households. This may suggest that CSG receipt helps overcome liquidity constraints for mothers in poor households and hence enables them to engage in active job search and in employment.

Cash transfers reduce child labour and can improve future labour market outcomes of today’s youth

CTs may have a direct labour market impact for beneficiary children by reducing the opportunity cost of having them in school rather than in the labour market. Indeed, evidence from Mexico, Brazil and South Africa suggests a negative impact of CT receipt on child labour (see Annex 2.A3 in OECD, 2011b, for a detailed list of studies on these issues). A strong negative impact of Progresa on hours spent on paid and domestic work is found by Skoufias and Parker (2001) for boys (only on domestic work for girls) and a similar negative impact of selected CCTs on child labour is found in Brazil by Ferro and Nicollela (2007). In South Africa, the CSG is also found to have a negative effect on child

Table 2.4. The labour market impact of the CSG differs across households\(^a, b, c, d\)

<table>
<thead>
<tr>
<th></th>
<th>Labour force participation</th>
<th>Broad participation</th>
<th>Employment</th>
<th>Unemployment</th>
<th>Broad unemployment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Panel A. All mothers</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>At least one CSG</td>
<td>-0.015*</td>
<td>0.012**</td>
<td>-0.063**</td>
<td>0.083**</td>
<td>0.084**</td>
</tr>
<tr>
<td>At least one CSG* poor</td>
<td>0.028**</td>
<td>0.019*</td>
<td>0.046**</td>
<td>-0.045**</td>
<td>-0.042**</td>
</tr>
<tr>
<td>Age eligibility</td>
<td>0.003</td>
<td>0.022**</td>
<td>-0.015</td>
<td>0.041**</td>
<td>0.037**</td>
</tr>
<tr>
<td>Age eligibility* poor</td>
<td>0.037*</td>
<td>0.041**</td>
<td>0.015</td>
<td>0.009</td>
<td>0.008</td>
</tr>
<tr>
<td><strong>Panel B. Mothers with children +/-2 years from eligibility cut-off</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>At least one CSG</td>
<td>-0.040*</td>
<td>-0.011</td>
<td>-0.084**</td>
<td>0.092**</td>
<td>0.101**</td>
</tr>
<tr>
<td>At least one CSG* poor</td>
<td>0.065*</td>
<td>0.055**</td>
<td>0.096**</td>
<td>-0.085</td>
<td>-0.073*</td>
</tr>
<tr>
<td>Age eligibility</td>
<td>-0.003</td>
<td>0.024</td>
<td>0.000</td>
<td>0.005</td>
<td>0.019</td>
</tr>
<tr>
<td>Age eligibility* poor</td>
<td>0.013</td>
<td>0.048*</td>
<td>0.014</td>
<td>-0.003</td>
<td>0.018</td>
</tr>
</tbody>
</table>

\(^a, ***, ***: statistically significant at the 10%, 5% and 1% level, respectively.\)
\(a\) CSG: Child-support grant. Samples include black Africans mothers aged 20-45.
\(b\) The results should be read two by two in every column as these are drawn from the same regression. They are marginal labour market effect on CSG receipt (or eligibility) and the differential impact for poor households. See note \(c\) in Figure 2.10 for a list of the variables included in the regressions and the definition of (broad) labour force participation and (broad) unemployment.
\(c\) Poor is a dichotomous variable taking the value one for households living in dwellings with very weak or weak state of roof. The results are very similar when either variable is used as a proxy for poor dwelling conditions and they are also robust (although less statistically significant) when alternative poverty proxies are used, such as whether the dwelling is informal and whether it has access to electricity.
\(d\) Observations are clustered at the household level.

Box 2.5. **Estimating the impact of the Child Support Grant on labour market outcomes**

A variety of methods are used to estimate the impact of CSG receipt on individual labour market outcomes (see Puymoyen and Xenogiani, 2011, for more details) taking into account, to the extent possible, that CSG receipt and labour market outcomes may be jointly determined by observed and unobserved factors, which complicates the estimation of the true causal effect of CSG receipt on labour market outcomes.

- First, a comparison is made between the labour market outcomes of mothers with an age-eligible youngest child and those of mothers whose youngest child is not eligible for the grant (first row in Table 2.3). The analysis controls for various characteristics at the individual and household levels such as education, age, marital status, household location and size to account for the possibility of endogeneity bias due to the joint determination of CSG receipt and labour market outcomes by observable characteristics at the individual or household levels. By using age eligibility rather than actual CSG receipt, it partly controls for unobserved characteristics which make some mothers more likely to apply for CSG than others, even though they all have age-eligible children. If mothers who apply for the grant have more motivation and are more informed relative to those who do not apply although they have eligible children, these characteristics may also imply that they will have different (improved) labour market outcomes which will be wrongly attributed to the CSG receipt on behalf of their youngest child.

- In a second estimation, labour market outcomes of women with youngest children who are one or two years below the age-eligibility cut-off point (and hence eligible to receive the CSG) are compared with those of women with youngest children who are one or two years above the age-eligibility cut-off point, who are not eligible for the grant. This analysis follows closely the study by Eyal and Woolard (2010) who conduct an in-depth and convincing evaluation of the impact of CSG on labour force participation of mothers. The econometric framework is a modified version of that developed by that paper as it estimates the impact on a broader set of labour market outcomes including a distinction between paid work, work in own business and domestic work (Puymoyen and Xenogiani, 2011). Moreover, it extends the analysis to all adult men and women in the household as evidence suggests that the impact may go beyond the main recipient (results can be found in Puymoyen and Xenogiani, 2011). If income is pooled within the household, then any potential effect of the grant on adult labour market outcomes should be similar whether it is the mother of the child or any other household member. Furthermore, the analysis controls for the age composition of the household and in particular of older children that the mother has or older children who live in the household as these are also likely to have a direct impact on labour market outcomes. Although this method is likely to better capture the true causal impact of CSG potential receipt on individual labour market outcomes, it also has certain weaknesses. It estimates the potential impact for a specific group of the population (that of adults/mothers in households with youngest children just above and just below the age-eligibility threshold). As a result, the coefficients are estimated on a smaller sample and hence are likely to be less precisely estimated. More importantly, the results cannot be easily generalised to the entire population.

1. The estimations have also been performed with CSG receipt as the variable of interest and the results can be found in Puymoyen and Xenogiani (2011). This variable is also used in the estimations on the restricted sample of mothers with children two years above/below the cutoff eligibility point in Table 2.4.

2. The lack of data prior to the increase in CSG recipiency rates (before 2002) does not allow conducting a differences-in-differences estimation similar to the one implemented in Eyal and Woolard (2010).
labour (Williams, 2007). Edmonds (2004) uses data for the late 1990s and finds that receipt of the OAP by a household member is associated with lower child labour, especially in households with low formal education.

Moreover, CTs can potentially affect labour market outcomes in the long-term through their impact on investment in health and education of beneficiary children. Empirical evidence shows positive effects of CTs on child nutrition and height for age in Brazil, Colombia, Nicaragua and South Africa. Such programmes are also found to have a positive impact on school attendance in a number of Latin American countries, including Mexico, as well as in South Africa [see Annex 2.A3 in OECD (2011b), for a review of relevant studies on these issues].\(^{55}\)

If the positive impact of CCTs on health, nutrition, education enrolment and attendance is translated into improved human capital and labour market outcomes for the future labour market entrants, this may imply a potential long-term labour market effect of such transfers.\(^{56}\) However, to date there is only limited evidence on the long-term labour market impact of CTs, mainly because the young beneficiaries of early CCTs are only now beginning to enter the labour market and solid empirical evidence on their labour market outcomes is still scarce.\(^{57}\)

### 7. Policy challenges and difficult trade-offs

Although differences exist across programmes and population groups studied, the evidence presented above suggests that the short-term effects of CTs on the incentives to participate in the labour market in the emerging economies are limited and tend to be less negative for the poorest households facing liquidity constraints. The longer-term labour market effects of CCTs can indeed be positive, if conditionalities related to investments in education and health translate into higher human capital of the future generation and lead to better labour market outcomes. Nonetheless, important challenges related to the design of CTs and their long-term strategy remain.

**The use and design of means-tests matter for the labour market effects of cash transfers**

All CT programmes have a major objective of reducing poverty by extending coverage to the poor. Means-tests, despite their costs and discouragement of the neediest individuals from applying, are recognised as an efficient way of achieving the objectives of CTs for a given budget (see the discussion in OECD, 2010a). However, because of administrative constraints (both in terms of budget and capacity), means-tests are infrequent in the majority of programmes operating in the emerging economies. Furthermore, proxy means-tests in many programmes only partially reflect real incomes and consumption levels and are rarely verified for their validity (except Oportunidades). Although these issues may result in loose targeting and the inclusion of non-poor households among beneficiaries, they are likely to lead to weaker – or no – labour market effects because the marginal effective tax rate imposed on labour supply would also be weaker in comparison with the situation in many OECD countries, where means-tests are appropriately conducted and verified in regular intervals. The experience of Oportunidades suggests that as CT programmes grow in emerging economies, more resources will be invested in means-tests and hence these are more likely to capture the real welfare situation of the household. However, at the same time,
more attention may be needed then to minimise the potentially increased disincentives for adult labour force participation.

There would be at least two possible ways to reduce the substitution effect on labour supply operating through the means-test. First, different thresholds for entry into and exit out of the programme could be established. Second, a gradual benefit withdrawal with additional earned income could be introduced and enforced.

In the case of social pensions, not only does the use of a means-test play a role in the potential labour market effects of CT programmes, but so also does the reference income used in it. In the OECD countries, usually only the individual’s income and that of his/her spouse are considered to determine eligibility for social pensions, as is also the case in South Africa. Along these lines, the 2008 pension reform in Chile changed the basis for the means-test from the household income to that of the individual and his/her legal spouse (OECD, 2009). Given the importance of extended families and multiple families in the same household in most emerging economies, this may have implications for household composition. Use of a household-level means-test in the case of social pensions may induce the elderly to move out from their household and away from their family in order to receive the maximum amount of cash from social transfers. As a result, informal child care usually provided by older household members in these countries will become scarcer, imposing care-related constraints on labour force participation of mothers and other adults in the household, which may have to be taken into account when designing care policies.

**Certain conditions need to be satisfied for conditionalities to work**

Despite concerns about the administrative cost and discouragement effects of CCTs (Fiszbein and Schady, 2009; Aguero et al., 2009), the existing evidence suggests that they have the potential to improve immediate or short-term health and education outcomes of beneficiary children. However, for conditionalities to work and be translated into longer-term improvements in human capital and labour market outcomes, certain conditions need to be met.

The efficiency of conditionalities depends on monitoring, and (enforced) sanctions in case of non-compliance. Both vary greatly across programmes and countries. The frequency of conditionality monitoring ranges from monthly (as was the case in the old Social Risk Mitigation Project in Turkey which ended in 2007) to once a year (SUF in Chile). The type of sanctions and their enforcement depend in turn on the type of conditionalities imposed and the administrative and enforcement capacity at the local and central government levels. Among the programmes examined in this part of the chapter, Oportunidades withdraws benefits either temporally or definitely according to non-compliance, while Chile Solidario imposes only light penalties and SUF no penalties. For example, in the case of Oportunidades the benefit for families is temporarily withdrawn after four months of non-compliance with health co-responsibilities, while it is permanently withdrawn if recipients sell or exchange their in-kind benefits (nutritional supplements). But even in the case of these programmes, sanctions are rarely enforced. Monitoring and enforcement of sanctions increase the cost of the programme and can have adverse effects on participation in the programmes for the poorest individuals, in particular for those in poor remote areas, for whom transportation cost can be high. Interestingly, there is evidence that mild verification and less-than-perfect enforcement could still work as even the announcement of conditionalities in a CT programme may induce participants to comply (Grosh et al., 2008).

The supply of health and education services of appropriate quality is a key factor determining the effectiveness of conditionalities (Grosh et al., 2008; Ribe et al., 2010, on
Teacher absenteeism and poor school and clinic infrastructure are common in emerging economies and in particular in remote rural areas of these countries. Evidence shows that distance from the nearest school matters for participation in Oportunidades (Grosh et al., 2008; de Janvry and Sadoulet, 2005) and transfers were usually not sufficient to allow households to pay the transportation cost to reach the nearest school and health centre in the context of the old Social Risk Mitigation Project in Turkey (Adato et al., 2007). Some countries have indeed made important steps to improve the supply and quality of such services (see Part C below). Chile Solidario offers an interesting example of interventions on the supply side by allowing for coordination among health providers, social workers and the municipalities. In the context of Oportunidades, the Mexican Government took important initiatives to increase the supply of schools in specific areas of the country by rehabilitating old rural schools and constructing new secondary schools (Levy and Rodriguez, 2004). Alternative ways to ensure appropriate supply of services include collaborations with NGOs and community groups. But implementation difficulties have been experienced in some cases.

Moving towards more integrated and complete programmes

Countries have difficulties in assessing whether a unique CT programme covering the vulnerable population is sufficient or if separate programmes targeting specific groups such as children, the elderly, the sick and the disabled or ethnic minorities, are needed. There is no strategy fitting all cases and the decision depends on the types of vulnerable groups, their presence among the poor, the family and household structure in the country and very importantly the political economy of potential reforms in the country. Overall, it is reasonable to believe that integrated programmes can effectively cover all the needy individuals while keeping administrative costs down. Oportunidades in Mexico has already made some steps towards that by including the Programme Apoyo para Adultos Mayores in the main programme targeting poor households. There are certainly other ways of exploring synergies across the different programmes, such as the use of common means-tests and administrative offices, as is the case in Chile, Mexico and Brazil (Grosh et al., 2008). Overall, special attention should be paid to ensuring equity in the case of unique programmes targeting the poor by, for example, making the level of the benefit paid a function of household characteristics and structure. This is currently the case in Mexico and South Africa where the number of benefits depends on the actual number of children, or Mexico and Turkey (in the old programme, Social Risk Mitigation project) where the benefit is also differentiated by grade or gender of the children, with higher amounts paid for secondary-grade children and for girls. A similar approach accounting for household composition should be followed if such programmes have to integrate those programmes targeting the elderly.

However, there are special cases in which CT targeting on a specific group may be needed. This is likely to be the case when such transfers can empower vulnerable members within the household and the community who are discriminated against by informal institutions and when the stigma associated with the receipt of the transfer for these groups is lower in the case of targeted interventions. Country experiences suggest that there is broader political support for interventions targeting the elderly as the need to focus on this group seems clearer to the public and hence easier to defend by politicians. Similarly, the stigma associated with the receipt of the transfer is likely to be smaller in the case of SPs in comparison with general CTs, especially if this is administered by a social security agency rather than a welfare one.
PART C.
Extending Health Protection Coverage:
The Labour Market Challenges

This part of the chapter will focus on how health protection systems and their extension may affect labour demand and supply. Compared with other social benefits such as unemployment benefits or cash transfers discussed in Parts A and B, health benefits per se provide no income to beneficiaries and are thus not likely to affect the labour supply directly. However, the financing of health benefits, when at least partly based on taxes weighing directly and exclusively on labour, such as social contributions, can have an impact on labour market outcomes. This implies that only emerging countries having mandatory contributory health insurance systems financed out of social contributions based on the wages of affiliates are considered in this part, namely Chile, China, India, Indonesia, Mexico, and Turkey. Brazil and South Africa, for their part, have fully-fledged universal national health services financed exclusively out of general taxation. Other effects of health protection on labour market outcomes transit through its impact on productivity. Health is a key factor for promoting productivity, and for the capacity to learn in school and grow physically and intellectually; better health is also likely to reduce work interruptions due to sickness. Although important, these effects are not addressed in this chapter.

One difficulty faced in examining the implications of the extension of health protection coverage for the labour market is that, in countries with health insurance programmes, it is often difficult, and perhaps even not relevant, to distinguish between the financing of health protection and that of social protection at large. In fact, the various existing social insurance programmes are often bundled together (e.g. Chile, Indonesia, Mexico and Turkey). And even when they are not by rule, they often are in practice, because employers contributing to one social programme most often also contribute to the others. Hence, the channels through which they affect the labour market are common, and they often have to be considered together.

8. Health protection systems and their coverage

Having access to health services is essential to the welfare of the population, as it is for economic and social development. For a large majority of the population, this is conditioned by the existence of a health system, which i) provides financial protection to make it affordable for people to access health services; and ii) allows effective access to these services by permitting the development of health services (infrastructure, workforce, medical goods and products).

Public health expenditures remain significantly lower than in most OECD countries

One important indicator of the development of the “health protection effort” is the amount of public resources allocated to health, which is a key factor for effective access to health care. Public health expenditure is obviously lower in the countries considered in this chapter than in most OECD countries, but there is also large variation among them (Figure 2.11). Public health expenditure is about 6 times lower than the OECD average in India and Indonesia and three times lower in China. Health expenditure is relatively higher in Chile, South Africa, Russia, and Brazil, and highest in Turkey. Mexico is in an intermediate position.
What does health protection coverage mean?

The degree of protection provided by the various health programmes is often referred to as the coverage of the system. This notion encompasses three dimensions (Figure 2.12). The first one is the extent of health protection, i.e. the share of the population who may potentially receive benefits from the programmes. The second is the scope of health protection, that is the range of health services that are covered. Finally, the level or depth of health protection corresponds to the proportion of the costs of the services that is covered. These three dimensions matter in measuring the effective protection provided by health systems to the population, as well as when discussing the extension of coverage.

Figure 2.11. Public expenditure on health
Percentage of GDP


StatLink: http://dx.doi.org/10.1787/888932479724

Figure 2.12. The various dimensions of health coverage

Governments have developed non-contributory programmes to compensate for the limited coverage of contributory health programmes

Historically, countries with contributory health insurance programmes have in fact had “two-tiered” health systems in place. First, for those contributing and often their dependents, health insurance programmes cover the costs of publicly or privately provided health services. These programmes cover workers in the formal sector, and thus a smaller share of the population than in higher income OECD countries. Yet, population coverage of the contributory programmes varies significantly across emerging countries: in Turkey and Chile they cover about two-thirds of the population, but only a small part of the population in China, India and Indonesia (Figure 2.13). In Mexico, social security covers more than half the population. Second, those not covered by health insurance have open access to a public provider network, financed out of general taxation.

Figure 2.13. Population coverage of contributory and non-contributory health insurance programmes

Note: Data refer to 2007 for Indonesia (contributory programme); 2008 for China, Mexico (contributory), Turkey and Indonesia (non-contributory); 2009 for Chile; and 2010 for India and Mexico (non-contributory); data for coverage of contributory programmes in India does not include the public employee programme.


However, open access to public health services does not imply effective health protection in practice because:

- Population coverage may be de facto limited because physical access to public health infrastructure is not always possible. This appears to be the case particularly in India, where the public health infrastructure is underdeveloped, and, given that health expenditures are decentralised at the state/local level, very inequitably shared across states and regions (PricewaterhouseCoopers, 2007). But lack of physical access in some regions is observed in many countries.

- The benefits provided by the basic public programme are generally much weaker than those provided by the contributory health programmes, implying that the scope and depth of health protection coverage (see above) is much lower for these groups. In these economies with limited capacity to raise taxes compared with most OECD countries,
2. THE LABOUR MARKET EFFECTS OF SOCIAL PROTECTION SYSTEMS IN EMERGING ECONOMIES

underinvestment in health infrastructure, staff and medicines often implies low availability and low quality of care. Patients often experience long waiting lists to get health services. In India, for example, it was estimated that less than 20% of the population which seeks outdoor services and 45% of those seeking indoor patient treatment avail of such services in public hospitals.\(^{60}\) The quality of public health care tends to be low, especially in some specific regions and/or in rural areas (see e.g. Brixi et al., 2011 for China; Rokx et al., 2009 for Indonesia; PricewaterhouseCoopers, 2007). Finally, effective access is limited by financial barriers: while primary care is often provided free of charges, public hospitals frequently charge fees for services, and sometimes high ones. In China, for example, fees represent the main funding source of public hospitals.

Governments in emerging economies have taken a number of policy measures to improve health protection coverage since the end of the 1990s. Some have taken initiatives to encourage workers not covered by the mandatory contributory programmes to join voluntarily the social security programmes, as in Indonesia and Mexico. However, the lack of significant subsidisation of contributions has resulted in very low levels of voluntary affiliation. Acknowledging that improving population coverage through health insurance programmes requires public subsidisation, all the emerging economies considered here have introduced some kind of non-contributory health programmes. But the strategies to extend coverage have differed in terms of: i) the benefits provided; and ii) the groups of population targeted:

- Chile and Turkey are fully subsidising contributions to the contributory health insurance programme for some groups, who thus get access to the same benefit package as those contributing to the programme. China, India, Indonesia and Mexico have set up separate non-contributory programmes (Table 2.5). The scope and depth of health protection provided by these separate health insurance programmes is higher than that available through the basic public network, but generally lower than that provided by the contributory programmes.\(^{61}\) Indonesia appears to be an exception, as benefits seem more generous in the non-contributory programme than in the contributory ones.\(^{62}\)

- Some programmes are targeted on the basis of income criteria (individuals with no income at all in Chile and no labour income in China’s urban areas, or poor households in India, Indonesia and Turkey). Other programmes have a broader scope: in China, a non-contributory health programme has been set up for all rural residents, while in Mexico, it is accessible to every household not covered by a contributory programme.

Some countries have also taken measures to improve the scope and depth of health protection provided by the contributory programmes. Since 2005, all those insured in Chile are guaranteed a certain basic set of health services (prevention and care) determined on the basis of epidemiological danger and feasibility of solutions (Plan AUGE). Micro-efficiency reforms have also improved the quality of care in Turkey. These reforms also benefit those whose contributions are fully subsidised.

All in all, depending on the size of the population groups concerned and the extent of benefit levels, the effective increase in protection resulting from the non-contributory programmes or programmes varies significantly across countries. It is probably highest in Mexico, where the non-contributory programme, Seguro Popular, provides quasi-free coverage on a sizeable number of health services to all those not covered by contributory health insurance. It is also high in Turkey and Indonesia for poor households, but non-poor informal workers remain uncovered. In Chile, protection has increased significantly for individuals with no income, but also for all the insured due to the AUGE plan. China has
Table 2.5. **Social health insurance programmes**

<table>
<thead>
<tr>
<th>Country</th>
<th>Targeted non-contributory</th>
<th>Subsidised contribution to mandatory programme for:</th>
<th>Separate programme for:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chile</td>
<td>All</td>
<td>Persons with no income</td>
<td></td>
</tr>
<tr>
<td>China</td>
<td>Urban employees</td>
<td>Rural residents</td>
<td>Urban residents not working</td>
</tr>
<tr>
<td>India</td>
<td>Employees in large formal firms</td>
<td>Poor households (central level)</td>
<td>Specific occupations (central and state level)</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Employees in firms with ten or more employees</td>
<td>Poor households</td>
<td></td>
</tr>
<tr>
<td>Mexico</td>
<td>Employees</td>
<td>Households not covered by contributory programmes</td>
<td></td>
</tr>
<tr>
<td>Turkey</td>
<td>Employed persons</td>
<td>Poor persons not covered by contributory programmes</td>
<td></td>
</tr>
</tbody>
</table>

Source: OECD Secretariat.

experienced a huge increase in the population covered, and, despite some progress, the main remaining coverage gap concerns migrant workers (about 15% of the Chinese population in 2008, out of which about a fifth was covered by the urban contributory programme, Zhu, 2009). However, the scope and depth of coverage of the non-contributory programmes, especially for rural residents, is still very low. Finally, in India, the coverage provided to poor households enrolled in the non-contributory programmes has increased significantly, but the extent of coverage of the programme remains limited, implying that most of the population remain largely unprotected against health risks.

**Out-of-pocket payments remain sizeable**

Despite the recent progress in health protection coverage, the share of out-of-pocket payments (OOP) in total health expenditure remains significantly higher in the emerging economies than in most OECD countries (Figure 2.14). OOP are particularly important in India, and Mexico, but also in China, where they covered respectively half and more than 40% of total health expenditure in 2008. They cover almost one third of total health expenditure in Indonesia, Brazil and Russia. Such direct payments can be very disruptive for households’ living standards, because they reduce the amount of resources available to meet the demand for other goods. This is especially the case for poor households, who have no room for shock absorption, but can also be true for relatively better-off households when the costs of healthcare are high (e.g. hospitalisation, medicines, forgone labour income). Higher levels of OOP payments have been found to be positively correlated with the share of households incurring catastrophic health expenditures (see Xu et al., 2003; and van Doorslaer et al., 2006), which have strong impoverishing effects. Besides, having to make important direct payments for healthcare often results in postponing health checks and not getting care when sick. This is particularly the case for the poorest, who probably need health care most. O’Donnel et al. (2008) indeed show that the better-off receive more health care than the poor in those Asian countries relying most heavily on direct payments, such as India and Indonesia.
9. The labour market effects of health/social protection: A case study of Mexico

The financing of health/social protection is more likely to affect the formal/informal composition of employment than its overall level

The effects of social contributions on the labour market have been widely discussed for OECD countries. Other things being equal, labour demand tends to decrease when labour costs rise. Hence, the overall effect on employment depends on how much the tax increase is passed through to wages, which in turn hinges upon the wage-bargaining framework (including possible minimum wage provisions) and how labour supply reacts to taxes. There are three different effects of a higher tax wedge on labour supply: i) a substitution effect, whereby a higher tax wedge reduces the opportunity cost of not working and thus tends to depress labour supply and generate wage resistance; ii) an income effect in the opposite direction, as households may raise their labour supply to compensate for higher taxes on wages; and iii) a perception effect as employees may be willing to accept lower after-tax wages if they perceive the individual and/or collective value of the benefits financed out these taxes. Empirical studies in OECD countries often conclude that higher taxes on labour tend to increase labour costs, especially for low-wage workers in the presence of a binding minimum wage. At average wage levels, labour taxes seem to be shared between higher labour costs and lower take-home pay, although the relative magnitude of these effects varies significantly across countries (OECD, 2007).

In emerging economies, however, the existence of a large informal sector and a large group of the population with very low income levels (which makes it more urgent to ensure daily subsistence rather than insure against health risks), as well as less developed administrative capacities of enforcement, increases the likelihood of evasion to the system. Hence, compared with most OECD countries, the overall effect of social contributions/the tax wedge on the labour market is likely to be much more important for the composition of employment rather than for the overall employment level – other things being equal, the higher the tax wedge, the higher the share of informal employment. This is precisely one of
the barriers these countries face when seeking to increase the coverage of contributory social programmes, which explains why some have resorted either to systems fully based on general taxation (Brazil, see Section 10) or to non-contributory programmes.

Tax-wedge calculations are available for four of the nine emerging economies only. Figure 2.15 shows an augmented tax wedge which, in addition to the taxes and social contributions, also includes those compulsory payments made to private programmes (such as pension funds in Chile and Mexico, unemployment accounts in Chile and housing fund in Mexico). For workers with relatively low wages, who are most likely to be concerned by informality, the augmented tax wedge is high in Turkey, 2 percentage points above the OECD average, despite recent reforms that have reduced it significantly (World Bank, 2010b). Mexico and Chile, on the other hand, have much lower tax wedges than most other OECD countries. For the other emerging economies, it is possible to compare social contribution rates only, although they provide partial information. Social contribution rates can be quite high in China, and close to the Turkish levels in Brazil and India (Annex 2.A2 in OECD, 2011b). By contrast, they are rather low in Indonesia and very low in South Africa.

Figure 2.15. **Augmented tax wedge, 2010**

Average compulsory payment wedge for a single worker paid at 67% of the average wage as a percentage of total augmented labour cost

Note: The augmented tax wedge corresponds to the difference between the labour costs and the take-home pay as a proportion of total labour costs.

a) Information on data for Israel: http://dx.doi.org/10.1787/888932315602.

Source: OECD (2010), Taxing Wages and OECD Secretariat for the Russian Federation.

Extending health coverage by introducing non-contributory programmes parallel to the contributory ones may increase the incentives for informal work, as providing free benefits to those who do not contribute to social programmes amounts to reducing the relative benefits of contributing to social programmes (see e.g. Levy, 2008, on Mexico). Differences in the nature of the benefits and in the financing between social security and non-contributory social security/health programmes result in a tax on formal salaried labour and a subsidy to (salaried or self-employed) informal labour. Higher costs on formal labour due to social security programmes, combined with other costs related to the regulation of formal salaried labour (e.g. employment protection legislation), could result in
higher informal employment and lower aggregate productivity. This theoretical argument applies to any country that runs contributory and non-contributory social protection programmes in parallel. Finally, Levy (2008) argues that, due to poorer quality and lower availability of healthcare facilities and other social security infrastructure in rural and small urban areas – where about two-thirds of the poor workers live – the value of contributory social benefits is lower for poor workers than for other workers, thus contributing to trap the poor into informality and poverty, which goes against the very objective of social policy.

The labour market model underlying Levy’s theoretical arguments is one of competitive labour markets where firms and workers make free choices between the two sectors. If it is indeed the workers’ choice to decide whether to contribute to social security or not, the provision of (quasi) free benefits to informal workers only should, other things being equal, increase labour supply in the informal sector compared with the formal sector which, in a partial equilibrium framework, should lead to an increase in informal employment relative to formal employment. However, institutions and market forces, such as the minimum wage, trade unionism and the collective bargaining framework, employment protection, efficiency wages, rent-sharing, etc., can also lead to imperfectly competitive labour markets, and segmentation between the formal and informal sectors. Factors related more to the business environment or the effectiveness of tax and labour law enforcement also play a role in the decision of firms to operate in the formal or informal sector. Hence, employers may decide, for all the possible reasons mentioned above, not to comply with regulations, including by not affiliating their workers to social security, and workers cannot always choose between a formal and an informal job. If workers have no choice, i.e. if the labour market is segmented, the provision of quasi-free health benefits to informal sector workers is unlikely to cause a shift in the employment composition towards informal employment.

Available research suggests that informal employment is very heterogeneous, both within and across countries. Studies on earning gaps and worker flows generally point to some workers, often among the self-employed, choosing to be informal and others, often low-qualified salaried workers, being trapped in informal jobs with few opportunities to access better jobs in the formal sector (see Annex 2.A3 in OECD, 2011b, for a review of the empirical literature on the formal/informal sectors segmentation). This is what Perry et al. (2007) refer to as exit or exclusion, outlining that there is a continuum in the relative importance of exclusion and exit among individual workers and firms within countries. Given that countries differ greatly in history, institutions and legal frameworks, there is also significant cross-country variation, with exclusionary mechanisms being more important in some countries and exit more important in others.

**Social protection and the incentives for informality: A summary**

Overall, for those who are in a position to choose, the contribution of social protection to the incentives to be/remain in the informal sector will depend on: i) the difference in the value of benefits provided for the workers; and ii) the difference in the costs of those benefits or, more synthetically, on the difference between net benefits (or net costs) in the contributory and the non-contributory programmes. The smaller the net benefits of contributing to social security programmes compared with being covered by the non-contributory programmes, the larger are the incentives to be/remain informal. Benefits value depends on effective access to benefits in the two programmes, on the
number of benefits available, as well as on their quality. The costs depend on the level of social contributions and the premium level for the voluntary non-contributory benefit. In turn, the level of social contributions will depend on the efficiency of the social protection system (or in a more restrictive sense on the efficiency of the health financing system).

But even for those who choose, the incentives for informality faced by workers are broader than those related to social protection. Employers, in the case of salaried informal workers, and the self-employed can evade many types of regulation, including tax and labour laws, which has implications for net earnings and working conditions. On the one hand, informal jobs might be inferior to formal ones in terms of earnings, safety, labour standards and job security. On the other hand, informal workers escape the labour income tax that formal workers have to pay. Informal jobs might also provide more autonomy and flexibility in the case of self-employed but also for women with children working at home.

Obviously, the relative size of the various incentives matters when assessing the impact of extending social protection through non-contributory programmes on formalisation. On the one hand, the higher the quality of the benefits provided by the non-contributory programme relative to those provided by the contributory programmes, the higher is the increase in incentives for informality. On the other hand, the higher the share of incentives not directly associated with social protection, the lower the impact of extension is likely to be.

**Non-contributory health programmes do not appear to be key drivers of informality**

Most of the empirical literature testing the effects of social protection expansion through non-contributory programmes focuses on Mexico. This is probably due to the fact that Seguro Popular (Box 2.6) is one of the largest non-contributory programmes implemented up to now and its implementation has raised a lively debate (see e.g. Levy, 2008). However, Juarez (2008) exploits a natural policy experiment based on the implementation of free health care in 2001 in Mexico City to analyse the compensating wage differential associated with working in the informal sector, as well as the impact on the probability to have a formal job after the policy change. She finds that women with at most secondary education are 4 to 10 percentage points less likely to have a formal job after the implementation of the programme. In the case of Turkey, World Bank (2010b) provides some evidence that the incentive effects of the Green Card, the non-contributory health programmes, are not key drivers of informality. The main explanation proposed for this is that the wage gap between the formal and informal sector is too high for the Green Card programme to make a real difference in incentives.

In the case of Mexico, Barros (2008) is among the first studies dealing with the possible spillovers of Seguro Popular on labour markets using data for the period 2002-06. The impact of Seguro Popular is identified by exploiting differences across states in terms of the implementation targets of Seguro Popular and time. The author finds no evidence that the implementation targets of Seguro Popular are correlated with the probability of being formal or the wage premium associated with being formal. Campos-Vazquez and Knox (2010) and Bosch and Campos-Vasquez (2010) both exploit the geographical variation in the actual implementation of Seguro Popular at the municipal level in order to identify its impact. While Campos-Vazquez and Knox do not find an impact of Seguro Popular using labour force data for the period 2002-06, Bosch and Campos-Vasquez do find a significant impact using IMSS-registry data for the period 2002-09. The authors estimate that the programme came at the cost of 300 000 formal jobs that would have been created otherwise, which
corresponds to 2% of total formal employment in 2009. However, compared with the size of the programme and that of the labour force, this effect is not large. These findings may suggest that the programme was simply not sufficiently large during the early years of its implementation to have a significant impact on the share of informal employment.

In order to shed some further light on the impact of Seguro Popular on informality, new econometric evidence is presented based on recent data for the period 2005Q1 and 2010Q3,
the period during which the coverage of Seguro Popular increased dramatically from 1.7 million affiliated families to roughly 14 million families. The impact of Seguro Popular is identified using a difference-in-differences estimator that exploits the staggered implementation across states. The analysis makes use of two different measures of programme supply: i) the actual share of households affiliated to Seguro Popular in the total; and ii) the targeted share of households, as agreed between the federal and state governments. The econometric analysis involves relating the within-state variation in the supply of Seguro Popular to the within-state variation in the incidence of informality conditional on any common macro-economic developments across states and various observable state characteristics (see Box 2.7). The key results are summarised by means of two scatter plots that relate the effective or targeted supply of Seguro Popular, after controlling for the role of state and time-fixed effects, to the incidence of informal work (see Figure 2.16). The results suggest no relationship between the roll-out of Seguro Popular and informal work. These results are robust to the inclusion of a variety of state characteristics. Moreover, no impact of Seguro Popular is found on the probability of moving from the formal to the informal sector or vice versa. These results are consistent with previous estimates that suggest no or a small effect of Seguro Popular on informality (for further details, see Del Valle et al., 2011).

The absence of any significant effects of Seguro Popular may be due to a combination of economic and methodological factors. First, once affiliated, families may not find the quality of health services offered as part of Seguro Popular to be of high value. This is obviously difficult to measure, and might also vary from one place to the other. However, an evaluation study by Urbina (2008) indicates that those insured by Seguro Popular generally found the treatment they received to be of good quality. Another reason may be that formal jobs are associated with other benefits (other social protection benefits or advantages not associated with social protection as discussed above) that cannot easily be compensated for when working in the informal sector. From a methodological perspective, one reason for not finding any significant effects may be that the state-level analysis presented here does not provide sufficient variation in the supply of Seguro Popular over time. However, further analysis reported in Del Valle et al. (2011) that exploits the staggered implementation of Seguro Popular across municipalities also suggests no significant impact. A more important reason for not finding any significant effects may be that there is substantial heterogeneity in the impact of Seguro Popular across different groups of workers or that the impact of Seguro Popular is only concentrated in a specific segment of the workforce. The number of potential movers for which informal and formal work represents relatively close substitutes may be small compared with the overall size of the workforce and this could explain the absence of any significant effects in the results here. Indeed, distinguishing between workers according to their propensity to move between the formal and informal sector, Del Valle et al. (2011) suggest that there may be a small adverse impact on high-propensity movers.
10. The policy challenges

Labour markets effects are not the main priority of health policies, and governments may decide that improving the health status of the population is what should be aimed for, even if it increases the incentives for informality. However, there are probably ways to design health protection and the extension of its coverage so as to minimise such “side” effects. Switching to general taxation instead of payroll taxes to finance health protection...
could possibly be one way to eliminate the incentives to informality arising from dual health protection systems. Alternatively, policy should work at improving the efficiency of existing programmes and increasing the consistency and incentive compatibility between the various programmes, so as to reduce the gap between contribution and benefits and favour enrolment of those who can afford it in the contributory programmes.

**Financing health from general taxation instead of payroll taxes**

Financing health benefits completely out of general tax revenues instead of payroll taxes, as done in Brazil and South Africa, would delink health protection from labour market status. It would hence remove the disincentives to formality arising from the co-existence of contributory and non-contributory health programmes. An additional advantage of such health systems is that health risks are effectively pooled across the entire population (Wagstaff, 2009). Finally, this would allow switching to a larger tax base and might thus reduce the tax wedge on (formal) labour (OECD, 2007), which may encourage formal-sector job creation.

Brazil actually switched from a three-tier social insurance system (social security, public and private) to a universal national health service financed by federal, state and municipal budgets in the early 1990s. The Brazilian reform was brought about by a political movement associating the demand for universality and equality of access in health care with the demand for a democratic regime (Lobato and Burlandy, 2000). However, in the absence of these specific conditions, such reforms might be difficult to implement. First, due to limited revenue-raising capacity as well as fiscal sustainability issues, switching to a tax-funded universal health system would imply lower health benefits than those provided by current contributory programmes (Ribe et al., 2010), thus reducing the effective coverage of those currently covered by such programmes. The better-off segments of the population could resort to private insurance as a complement (top up). In Brazil and South Africa, for example, voluntary private insurance respectively covered 20 and 16% of the population in 2009 and 2010.75 However, when the package provided under the national health system is
relatively low, this raises equity issues. In addition, the higher the population coverage of existing social security programmes, the higher the resistance to this change is likely to be. Second, due to a significantly narrower tax base in emerging economies than in most OECD countries, a switch towards general taxation might not be as advantageous in terms of reducing the distortionary effects of taxes on labour. Raising income and corporate taxes, which weigh mainly on the formal sector, would limit the reduction in disincentives to formality. Consumption taxes would have no direct employment effects, but they tend to be regressive, which is at odds with the aim of such a reform.

Reducing costs through better integrating contributory programmes

In most of the countries studied, there are multiple contributory programmes and sometimes additional non-contributory programmes (Table 2.5). There is thus room for more risk pooling, as it would reduce the overall cost of contributory programmes. Risk pooling refers to the collection and management of financial resources in a way that spreads financial risks from an individual to all members of the programme. From a policy perspective, risk-pooling arrangements attempt to manage the need to subsidise care for people with the highest health risks (horizontal redistribution), the lowest ability to pay (vertical redistribution), or both when facing a health shock (Baeza and Packard, 2006). Besides, by exploiting economies of scale, risk pooling can reduce the average cost of the benefit package compared with multiple programmes, each with their own administrations and information systems. Fragmentation can also lead to adverse selection and cream-skimming. Usually, one of the pools will provide benefits to the relatively wealthy groups, who will not want to cross-subsidise the cost of poorer, less healthy groups (WHO, 2010). When health insurance programmes also provide healthcare, fragmentation also tends to increase the overall administrative costs of healthcare. Mutual exclusivity across programmes can also lead to inefficiencies in the production of health care (for example low use of capacities in health facilities and suboptimal allocation of care, duplication of facilities).

Cost reductions from more risk pooling would be large in a number of countries. This is particularly the case in China where the thousands of county/municipal-level programmes within each province increase the overall cost of health protection, generate significant regional inequalities, and raise equity issues for migrants as workers cannot claim health benefits outside the region where they contributed. In Mexico, there are at least five contributory programmes and Seguro Popular, and spending on administration represents more than 11% of total health expenditure, the highest level in the OECD (Joumard and André, 2010). Chile, in the mid-1980s, actually merged the social security institution and the national health system into the current public health programme (FONASA). But individuals can choose between public and private insurance, which results in private insurers covering mostly the higher income individuals with relatively low health risks. As a consequence, public insurance faces higher costs than if there was a single pool (Bes, 2008). Turkey has recently integrated the three previously separated programmes for public employees, private employees and self-employed into a single one (OECD, 2008c). In countries where separate programmes remain, compensating mechanisms between the programmes to reduce the cost differences could be introduced, as for example in Colombia but also the Netherlands and Switzerland. However, this requires political will and technical and administrative capacity (WHO, 2010).
Enrolling the self-employed who can afford it in mandatory health insurance programmes

The fact that workers may not fully value the benefits of social programmes does not in itself imply that the state should not try to enforce social protection legislation. Health programmes could be well designed and performing and yet insufficiently valued by workers because they are myopic or prefer to free-ride. Hence, in addition to reducing the costs and increasing the benefits of health protection, there may also be scope for improving enforcement of mandatory programmes on some groups who can afford to contribute, in particular relatively well-off self-employed. For example, in some countries, such as China, Indonesia, and Mexico, the self-employed are excluded from the mandatory contributory programmes. Making it compulsory for them to participate, as is the case in most OECD countries with mandatory contributory health programmes, is a policy option worth considering. If made mandatory for all self-employed, the premiums should obviously take account of the income level, as for many workers in emerging economies, self-employment is a subsistence strategy. Apart from those with high income levels, such as for example professionals, partly subsidising contributions is probably necessary to significantly increase coverage. This is what was actually done in Korea, where government subsidies accounted for 44% of the revenues of the self-employed health programme in the first year of implementation at the end of the 1980s, and were progressively reduced through time (Kwon, 2002). Increasing the coverage of self-employed workers also implied reforming at the same time the tax system and improving income assessment methods.

Facilitating transitions between contributory and non-contributory programmes

In most countries, non-contributory programmes were designed to provide coverage to those who cannot afford to contribute, i.e. to the poor. For this group, public subsidies are the only way to provide health protection, and the policy challenge is to achieve good targeting. But in the case of non-poor households not contributing to health insurance programmes, policy challenges differ. While some public subsidy is required to make them join a health protection programme, full subsidisation should be avoided, because it could reduce the incentives to join the contributory programme.

Currently, China and Mexico are the only countries where participation to the non-contributory programme is not conditional on income but on residence in the case of the Chinese rural medical programme and non-registration with a contributory programme in the case of Seguro Popular. In China, given that there is no contributory programme in the rural areas, the problem is not to render it incentive compatible, but more to ensure fiscal sustainability in the long run, as the scope and depth of coverage of the programme progress. Besides, the geographical segmentation between programmes may also constitute an obstacle to labour mobility between rural and urban areas. In Mexico, households not belonging to the first two income deciles should in principle pay a premium increasing with the income level – equivalent to 0.5% and 7.7% of the total average income in 2008 for households in the third and tenth deciles, respectively. However, pushed by the objective of rapidly expanding coverage, the income evaluation method used at the inception of the programme79 was replaced by a simpler and less effective system (Lakin, 2010). As a result, very few families pay any premium – less than 3% of the eligible families in 2008 (Lakin, 2010). Figure 2.17 shows that more than 60% of the households affiliated with Seguro Popular in 2008 were, in fact, not in the first two income deciles and should, in principle, have paid a premium. And more than a fourth of affiliated
2. THE LABOUR MARKET EFFECTS OF SOCIAL PROTECTION SYSTEMS IN EMERGING ECONOMIES

households belonged to the top half of the income distribution. In Turkey, where the Green Card is currently restricted to poor households – and actually well-targeted (World Bank, 2010b) – there was also a plan to introduce a reduced premium based on a means-test for those not qualifying as poor but not yet covered by the contributory programme (OECD, 2008a), but it has not been implemented yet. This highlights the importance of the (proxy-) means test (see Part B).

**Increasing the benefits of participating to the contributory programmes for informal workers**

On top of providing benefits in an efficient way, social protection programmes should be adapted to informal workers’ needs to improve their incentives to join. This might imply some degree of unbundling in some countries where all social contributions are tied together. In Mexico, for example, the housing and childcare contributions could be separated from the health and pension parts, as most poor workers often cannot access these services. The government has recently taken some steps in that direction (OECD, 2011a). When health and pension contributions are tied together, as in Chile, Mexico and Turkey, this may also imply adapting the rules for pension contributions to the workers’ needs, notably by providing them more flexibility in the contributions. Irregular contributions are allowed for temporary or seasonal workers in Chile for example, so as to accommodate the relatively large fluctuations in their income (Hu and Stewart, 2009).

**Conclusions**

This chapter has analysed the labour market effects in emerging economies of three major components of social protection: unemployment compensation, cash transfers and health-care benefits. While these programmes are primarily intended to deal with social policy objectives, they also have important implications for employment policy. These may be negative when social protection reduces incentives for work, particularly for work in the formal sector, but may also be positive by allowing cash-poor households to make better employment choices. Taking account of the potential labour market effects in the design of
social protection systems can make a major contribution to their cost-effectiveness. Based on the analysis presented in this chapter a number of conclusions can be distilled that may also be of relevance for other emerging economies:

- **Target support to those who need it most.** This can help in achieving better labour market outcomes and is desirable from a social policy perspective. A high incidence of poverty and liquidity constraints in emerging economies are likely to constrain labour market choices and thus reduce labour force participation or increase labour market mismatch. The evidence provided in the chapter on the labour market impact of the Child Support Grant in South Africa and income support to job losers in Brazil suggests that these benefits allow the most cash-poor individuals to engage in more effective job search in the former case and reduce the pressure on them to accept unsuitable jobs in the latter. A fruitful avenue for future research would be to identify how cash transfers allow for more effective job search and how income support to jobseekers affects re-employment outcomes in terms of job stability and wages.

- **Unify separate programmes or combine different policies under a common umbrella.** More integrated programmes reduce the overall cost of social protection by reducing administrative costs and, in the case of social insurance programmes, by increasing risk pooling. This would make social protection systems more effective. The creation of non-contributory programmes alongside contributory ones allows for an increase in social protection coverage, notably for health. However, such non-contributory programmes should be designed so as to minimise the disincentives that may arise to work formally. This can be done by enforcing means-tested fees with a subsidy element which decreases as income rises, thus allowing a smooth transition towards the contributory programme. An alternative would be to switch to a universal tax-financed health system, as was done in Brazil. Moreover, policies that integrate income support policies with policies to assist beneficiaries in their job search or to overcome social problems (e.g. the anti-poverty programme Chile Solidario) can also be important. They go beyond the short-term alleviation of hardship by addressing the underlying source of the problem such as poverty and unemployment.

- **Increase the use of mandatory self-insurance based on individual saving accounts for those who can afford it and provide a redistributive component for those who cannot rely on individual savings.** This would reduce the cost of unemployment protection. Mandatory self-insurance provides incentives for workers to stay employed or return to work when unemployed and possibly increases the incentives to work formally. This may free up resources that could be used to help those with insufficient savings and enhance the protection of the most vulnerable. The Chilean unemployment insurance system of individual unemployment saving accounts (Régimen de Seguro de Cesantía) in combination with a Solidarity Fund (Fondo de Cesantía Solidario) provides an interesting example of self-insurance combined with income support in the event of job loss for the poor. The effectiveness of these OECD recommendations will depend upon the extent to which means testing can be reliably carried out. However, the importance of income from informal work for many households as well as the relatively limited administrative capacity suggest that income testing is difficult in emerging economies. There are nevertheless examples of successful “proxy” means-testing, such as the one used in the Mexican conditional cash transfer programme, and this is certainly one area in which emerging countries should be encouraged to invest.
2. THE LABOUR MARKET EFFECTS OF SOCIAL PROTECTION SYSTEMS IN EMERGING ECONOMIES

Notes


2. The authors would like to thank Alejandro Del Valle for his excellent work on the econometric analysis of Seguro Popular.

3. Moreover, having more extensive social protection systems before the crisis also facilitated the use of counter-cyclical fiscal policies through the use of automatic stabilisers.

4. The economic importance of these nine economies is substantial. Together they account for half the world’s population and a fifth of the world’s exports and GDP.

5. The number of workers contributing to social insurance programmes is more easily available for pension programmes than for health programmes. Questions related to health in household surveys generally relate to access to health care rather than contributing to health insurance.

6. The share of the workforce contributing to social insurance programmes is one of the measures frequently used for formal employment and the preferred definition in this chapter. However, there is no universally accepted definition of informal employment. For a discussion of the definition and measurement of informal employment, see OECD (2008a).

7. This is generally associated with a reduction in the share of agricultural employment in those countries (OECD, 2010a).

8. Non-contributory pensions represent a substantial share of household income for the poorest three quintiles in South Africa. Their contribution is also important in Chile and Brazil.

9. Although severance pay is not part of social protection, the focus of this chapter, it represents an essential component of unemployment compensation systems in emerging economies. Any discussion of unemployment protection for job losers should therefore take account of this.

10. However, given the very low level of unemployment assistance benefits, these are unlikely to represent an important part of the overall support available to job losers (OECD, 2010a).

11. While SP may be considered a compensation for the wage loss associated with job displacement due to the loss of match-specific human capital, it is less effective in providing protection to workers once unemployed: too little support may be available for workers at risk of long-term unemployment, while job losers with good job prospects may be overcompensated.

12. To the extent that such jobs entail higher growth and workers are risk-averse, this provides an efficiency justification for UI (Acemoglu and Shimer, 1999).

13. The basic idea of experience-rated UI systems is to remove the implicit subsidy from low-risk to high-risk firms that is present in traditional UI systems by replacing payroll or ear-marked taxes as the main source of finance by layoff taxes.

14. No emerging economy has an experience-rated UI system.

15. Restricting the analysis to job losers with nine months of tenure in their last job does not change the conclusion that income support in emerging economies tends to take the form of SP. However, it does suggest that, in comparison with advanced economies, income support to the unemployed tends to be biased towards job losers with relatively high levels of tenure in their previous job, which raises concerns about their effectiveness to protect the most vulnerable (see Annex 2.A2 in OECD, 2011b for details).

16. Mexico has a positive level of UB in Figure 2.4 because of its system of individual pension accounts that can be used for the purposes of unemployment under certain conditions. Mexico does not have a UI system.

17. However, severance pay included in collective agreements or private contracts may be quite important in many of these countries.

18. In addition, judicial procedures related to disputes over the reason of dismissal tend to be time-consuming and costly in many emerging economies, resulting in financial insecurity for firms and inadequate compensation for dismissed workers (Venn, 2009).


20. Adverse selection arises when workers have information on their own risk of job loss that is not available to insurance providers. Moral hazard arises because unemployment insurance reduces worker incentives to avoid job loss or find a new job once unemployed. In principle, governments can improve welfare by making UI mandatory and taking an active role in its provision to ensure
active job search by benefit recipients. The mandatory nature of UI precludes the possibility of adverse selection, while public authorities are typically better placed to administer and monitor benefit eligibility than private providers.

21. To the extent that tracking UI recipients may be infeasible in emerging economies with substantial informal sectors, UI may be considered a form of severance pay with periodic payments (Parsons, 2010).

22. The emphasis is on the effects of unemployment compensation systems on individual labour outcomes in partial equilibrium, in line with much of the evaluation literature. However, general-equilibrium effects can be very important. To a limited extent, these are discussed in Section 4.

23. Bassanini et al. (2010) show that country differences in the stringency of employment protection (EP) account for as much as 20 to 30% of the country variation in worker turnover. Moreover, a more detailed analysis of the components of EP suggests that the level of SP is an important factor behind this result.

24. Although these inefficiencies can in principle be circumvented by passing the cost of severance pay on to workers in the form of lower wages (“wage shifting”) or via the design of efficient contracts, this is unlikely to be fully realised in practice due to the role of financial market imperfections, wage rigidities and uncertainty about the future of the firm (Lazear, 1990).

25. This may also explain why countries with strict employment protection tend to have relatively high unemployment rates among youth.

26. This estimate is based on two alternative experiments that show, respectively, that the impact of UI on unemployment duration is greater in liquidity-constrained than in unconstrained households and that SP also increases the duration of unemployment, despite not being conditional on being unemployed (Chetty, 2008). Similarly, Card et al. (2007a) show that SP equal to two months of previous earnings reduces the job-finding rate by about 10%. Moreover, an extension of the maximum duration of unemployment benefits from 20 to 30 weeks lowers the job-finding rate in the first 20 weeks of search by 5-9%.

27. In order to address this issue one needs to distinguish between the probability of returning to a job in the formal sector and that of starting to work informally. This is done below.

28. Indeed, the changes in the law are of similar magnitude to the differences in eligibility between different tenure groups, which also in the present case are associated with rather small and typically insignificant differences in the job-finding rate.

29. Household income is measured as total labour income by other household members at the start of non-employment divided by the square root of household size (OECD, 2008b). This is the most appropriate measure of liquidity-constrained households that can be constructed with the present data. Ideally, one would like to measure liquidity constraints using household wealth or total household income (and not just that from labour).

30. The figure only focuses on the average probability of starting a new job within the first six months from the time of job loss since it was shown in Figure 2.6 that unemployment compensation only affects the non-employment duration during the first couple of months of non-employment.

31. However, the analysis attempts to control for unobserved individual characteristics that may be correlated with working in the formal sector.

32. There are many studies on the effects of unemployment compensation for the re-employment outcomes of job losers in developed countries, but also there the evidence is rather mixed. Card et al. (2007b) for Austria and Van Ours and Vodopivec (2008) for Slovenia do not find an impact of UI on job quality or job stability, while Caliendo et al. (2009) for Germany and Tatsiramos (2009) for a number of European countries find positive effects.

33. While previously informal workers have a much higher chance of returning to informal work, whether in the form of salaried work or self-employment, consistent with findings reported in Margolis (2008), this difference is only slightly larger for long-tenure workers than for short-tenure workers.

34. For employees, this effectively represents a sort of mandatory saving that offers protection against unemployment. Such payment programmes have not been taken account in Figure 2.1 as they do not explicitly relate to job loss or unemployment.

35. Rather than treating SP and UI as substitutes, it may be also be possible to enhance their complementarity. For example, one may make SP conditional on eligibility for UBs. This is effectively the case in Chile, where employers are allowed to subtract their UI contributions made...
in the account of a worker from SP. This means that severance pay is relatively more important for job losers with few entitlements to UBs. Alternatively, UBs can be made conditional on the number of monthly wages worth of SP. Such an arrangement exists in Canada.

36. While the authors claim their findings reflect moral-hazard effects, it is not clear why liquidity effects could not play a role as well. Take-up of the Solidarity Fund is likely to be driven by liquidity constraints, which, as has been shown for Brazil, affects the duration of unemployment.

37. Another concern with IUSAs is that they provide incentives for workers to collude with their employers over dismissals to gain access to their accounts (see Box 2.2).

38. An advantage is also that it can be implemented relatively quickly in response to a crisis (Robalino et al., 2009).

39. While the authors claim their findings reflect moral-hazard effects, it is not clear why liquidity effect could not play a role as well. Take-up of the Solidarity Fund is likely to be driven by liquidity constraints which, as has been shown for Brazil, affect the duration on unemployment.

40. In Brazil, about a third of benefit applications are handled by the network of local public employment offices (SINE) (Gonzalez, 2010).

41. The main cash transfer programmes operating in emerging economies, excluding those targeting the elderly, were examined in detail in OECD (2010a).

42. In 2011, Chile introduced a new conditional cash transfer programme which encompasses Chile Solidario and includes conditionalities related to health, education and women’s employment. The first payments were made in April 2011 and hence data on the coverage and expenditure are still limited.

43. The impact of CTs on poverty was thoroughly examined in OECD (2010a) and hence is not reviewed here.

44. Any labour-market-related moral-hazard effect is likely to be less relevant in the case of CTs to the elderly who are anyway out of the labour market, especially in countries where life expectancy is substantially lower than in the OECD. Other types of medium to long-term effects include the impact of the existing pension system on the incentives to contribute throughout one’s working life. However, this issue may be less relevant in the emerging economies, where frequent major reforms of the pension system take place and hence there is little certainty with respect to the existence or not of the current programmes in ten or twenty years later. Other short-term effects are those of the transfer on the actual beneficiary in the case of transfers to the elderly and subsequent impact on retirement age (see Piggott et al., 2009, for empirical evidence on this).

45. A study by Mitra (2009) on the generous South African Disability Grant (DG) finds negative effects on broad labour force participation (includes discouraged workers who would be willing to work if an offer was made to them but would remain unemployed otherwise as they do not actively engage in job search) of older men (55-64). The study finds no significant impact on the labour force participation based on the narrow definition (which only includes the unemployed who actively search for a job) implying that less stringent screening techniques pushed out the discouraged workers from the labour force while not impacting the existing labour force.

46. A recent study by de Carvalho Filho (2008) on Brazil uses a triple differences-in-differences approach and exploits a major reform of Prêvidencia Rural that took place in 1992 and introduced a simultaneous change in age eligibility, an increase in the amount of the benefit and expanded eligibility to non-heads of households. The study presents evidence of reduced employment rates and total hours of work associated with the generous transfer to rural labourers. Given that the programme is not means-tested but instead universal for workers in rural areas, the negative impact of Prêvidencia Rural on labour supply reflects a pure income effect associated with a fairly generous transfer amounting to 36% of average wages.

47. Some positive labour market effects have been also found in the case of Brazil. Delgado and Cardoso (2000) argue that many beneficiaries use some of the transfers to purchase seeds and tools to support their economic activity. The study finds a higher incidence of continued employment among beneficiaries of Prêvidencia Rural compared with other pension programmes in Brazil.

48. However, the GHS data do not allow the analysis of the impact of the OAP on non-resident household members.

49. The General Household Survey (GHS) data do not allow a classification of households according to their total incomes or wealth and the information on household expenditure is of limited use when different years are pooled together as it is a categorical variable with fixed brackets that do not adjust to take into account inflation. Access to the main providers of electricity, the quality of
the dwelling’s roof and walls as well as the type of dwelling are used instead to identify poor households.

50. The analysis of the type of work presented in Puymoyen and Xenogiani (2011) suggests that among employed adults, there is a higher incidence of domestic work both for poor men and women and relative to adults in non-OAP eligible households, but also relative to those in OAP-eligible non-poor households.

51. More mixed results on Brazilian CCTs are shown in Ferro and Nicollela (2007) and Tavares (2008).

52. These correlations are consistent across the different specifications (results reported in Puymoyen and Xenogiani, 2011) and hold when the variable of interest is CSG receipt and the total number of CSGs received by a mother on behalf of her children. When a distinction is made between men and women, CSG receipt or potential receipt (proxied by age eligibility of children in the household) is negatively associated with participation and employment for men and women in the household, and positively associated with the probability of unemployment.

53. According to the results in Puymoyen and Xenogiani (2011), CSG receipt or potential receipt (proxied by age eligibility of children in the household) is negatively associated with participation and employment for men and women in the household, and positively associated with the probability of unemployment.

54. Poor households are defined on the basis of the quality of the roof of their dwelling, but the results are robust to the use of alternative measures for household poverty.

55. Existing evidence also suggests that there is an important gender dimension in the effects on health, education and child labour. The impact on education and child labour seem to be greater for girls than for boys (Hamoudi and Thomas, 2005). In addition, who receives the transfer also matters for the impact of the transfer on children’s outcomes. Most studies on the South African OAP find evidence of higher effects when the recipient is a woman (Case and Ardington, 2006; Case and Deaton, 1998).

56. Such potential effects may also apply to the case of unconditional CTs, as long as the additional household income is used to finance school fees, uniforms, books and other school-related expenses, providing a potential further boost to school attendance and performance.

57. Rodríguez-Oreggia and Freije (2009) use the 2007 panel wave of the Rural Households Evaluation Survey in Mexico and find little evidence of impacts of Oportunidades on employment, wages or inter-generational occupational mobility among the cohort of beneficiaries under study. This could be explained by either limited labour market prospects in the treated rural localities or low-quality education and health services minimising the potential improvement in future labour market outcomes of today’s beneficiaries (see Section 4 for a discussion on the quality of health services in emerging economies). Using MxFLS-1 for 2002, McKee and Todd (forthcoming) simulate earnings distributions, with and without Oportunidades, to find that programme participation will increase future mean earnings but have only modest effects on poverty rates and earnings inequality.

58. Although partly financed from social contributions, Russia’s health system de facto operates along the same lines.

59. In India and Mexico, the social health insurance programmes not only cover costs but also provide health services through their own infrastructure and staff.

60. Source: India National Health Profile, WHO, www.searo.who.int/LinkFiles/India_CHP_india.pdf.

61. The Mexican programme provides free access to a sizeable number of health services, the Indian programme covers hospitalisation expenses for a large number of health problems – but up to a certain amount and for a maximum of five persons per household, and not non-surgery-outpatient care; finally, the Chinese programmes cover major diseases and hospitalisation fees, but with a much lower reimbursement rate than the contributory programme.

62. See http://jointlearningnetwork.org/content/jamkesmas.


64. In India, it is mainly the result of people paying for healthcare services in the private sector, while in China OOP mostly stem from fees paid in the public sector (Saksena et al., 2010). In China, public hospitals function on a fee-per service basis, and fees account for 90% of their operational funds (Hu, 2008).

65. In India, 20 million households were estimated to fall into poverty each year due to health expenditures (PricewaterhouseCooper, 2007). In China, in 2008, 10% and 6% of the low-income
households in rural and urban areas, respectively, experienced catastrophic health expenditures (Brixi et al., 2011).

66. For a comprehensive discussion of the employment effects of financing social protection, see OECD (2007), Chapter 4.

67. This effect holds under the condition, which is often the case in OECD countries, that non-labour-market incomes are less taxed than wages.

68. This is mainly because the need for informal businesses to hide their activities obliges them to remain small, thus constraining their access to credit and thereby their investment.

69. For a discussion of the role of various policies in determining informality in a number of low-income OECD countries, see OECD (2008a).

70. For a presentation of the various models describing labour markets with formal and informal sectors, see Fields (2005).

71. However, as noted by Perry et al. (2007), it is sometimes difficult to distinguish the two: a microentrepreneur concluding that formality is not worth its costs may be explicitly excluded or self-excluded. On the other hand, poor workers excluded from healthcare services because they live in remote rural areas or a poor urban neighbourhood may see little point in paying labour taxes for services to which they have no access.

72. Camacho et al. (2009) study Colombia’s 1993 health reforms that considerably expanded the availability of non-contributory health insurance to the poor. They identify the impact of the expansion in non-contributory health insurance by exploiting the staggered time profile with which eligibility was determined across municipalities. Their empirical findings suggest that there might have been a small negative impact on formal employment. However, the simultaneous increase in labour taxes makes it hard to draw firm conclusions.

73. Azuara and Marinescu (2010) also find that the effects of SP are small or insignificant. To the extent there are any negative effects the effects appear to be concentrated among low-skilled workers, married workers with children or the young (below 34).

74. According to available data, the expenditure per capita in Seguro Popular was about 42% of that in the social contributory programmes, but this gives only an indication since it includes administrative costs of the programme, and quality is not directly related to health spending.

75. Source: Jurberg and Humphrey (2010) for Brazil, and McIntyre et al. (2008) for South Africa.

76. However, they may generate upward wage pressure to compensate for reduced purchasing power.

77. Designing a compensating mechanism for poor households, as suggested for example by Levy (2008), implies additional tax reform, which may not always be feasible.

78. Bes (2008) indicates that as they grow older, individuals insured by private insurance face increased premiums and often return to the public programme, which ends up spending high amounts for individuals who have not contributed to the public system earlier in their life.

79. It was the method designed for the anti-poverty programme (see Section 3).

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2. THE LABOUR MARKET EFFECTS OF SOCIAL PROTECTION SYSTEMS IN EMERGING ECONOMIES


2. THE LABOUR MARKET EFFECTS OF SOCIAL PROTECTION SYSTEMS IN EMERGING ECONOMIES

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